

November 28, 2001

Martha P. Willis
Division Director
Florida Board of Accountancy
240 NW 76th Drive, Suite A
Gainesville, FL 32607

Re: Potential Conflicts of Interests Disclosed in Responses of Proposers Seeking to Provide Financial Management and Accounting Services for a Capital Construction Program.

Dear Ms. Willis:

This letter is to request your opinion on two conflicts of interests disclosed in responses of proposers seeking to provide financial management and accounting services for a capital construction program. Accordingly, please place this matter on the Board's next agenda for their review.

A governmental entity ("Governmental Entity") recently solicited responses from accounting firms ("Governmental Entity's Solicitation") interested in providing financial management and accounting services for a major capital construction program of the Governmental entity ("Capital Construction Program"). The Capital Construction Program includes several individual construction projects, with many different general contractors, architects, engineers, other consultants, subconsultants and subcontractors being employed by the Governmental Entity to perform work on the various projects (all such firms are referred to collectively as, "CCP Firms").

Eight accounting firms responded to the Governmental Entity's Solicitation. Generally two types of potential conflicts of interest have been identified for which we seek guidance. These potential conflicts fall under Section 473.315(1) and Section AU 220.01 of the Codification of Statements on Auditing Standards, published by the American Institute of Certified Public Accountants (AICPA).

Section 473.315(1) provides that: "A certified public accountant shall not express an opinion on the financial statements of an enterprise unless she or he and her or his firm are independent with respect to such enterprise."

The Codification of Statements on Auditing Standards, published by the American Institute of Certified Public Accountants, provides in Section AU 220.01 among other things, that the general standard for independence of an auditor is: "In all matters relating to the assignment, an independent mental attitude is to be maintained by the auditor or auditors."

- (1) First Potential Conflict: The first question for which we seek guidance concerns the Governmental entity's current external auditor (“External Auditor”).

Facts:

- (a) The external Auditor, which expresses an opinion on financial statements for the Governmental Entity as a whole and its component entities, desire to conduct financial management accounting services for the Capital Construction Program. The Capital Construction Program is an activity of one of the components of the Governmental Entity for which the External Auditor expresses an opinion on the financial statements as a whole. The services for the Capital Construction Program have been identified as providing assistance in the financial management, development, monitoring and control of the program. These services would include the financial areas of: (i) project development, (ii) project financial controls, (iii) funding sources and uses, and (iv) contract review, auditing and closeout.

The External Auditor concludes that it does not have a conflict and that its independence will not be impaired because it will limit its work for the Capital Construction Program in order not to perform any management functions decisions. The External Auditor cites the AICPA Code of Professional Conduct, Section 100, Independence, Integrity and Objectivity.

- (b) Same facts as above, except a subconsultant to the External Auditor has proposed to perform the accounting services for the Capital Improvement Program. This subconsultant performs auditing services for the Governmental Entity or its component entities, as directed by the External Auditor. This subconsultant does not express an opinion on the financial statements of the Governmental Entity as a whole.

Issues:

- (a) For purposes of Section 473.315(1) and underlying interpretive rules, if any, and Section AU 220.01, if the External Auditor is retained by the Governmental Entity to provide (i) project development, (ii) project financial controls, (iii) funding sources and uses, and (iv) contract review, auditing and closeout for the Capital Construction Program, would the External Auditor be considered independent when it provides an opinion on financial statements for the Governmental Entity as a whole and its component entities, which includes the Capital Construction Program?
- (b) For purposes of Section 473.315(1) and underlying interpretive rules, if any, and Section AU 220.01, if the subconsultant to the External Auditor is retained by the Governmental Entity to provide (i) project development, (ii) project financial controls, (iii) funding sources and uses, and (iv)

contract review, auditing and closeout for the Capital Construction Program, would the subconsultant be considered independent when it performs auditing services for the Governmental Entity, while under the direction of the External Auditor?

Conclusions:

- (a) A conflict of interest is clearly indicated whereby the External Auditor performs accounting services when expressing an opinion on the financial statements of the Governmental Entity as a whole. It is unclear at this time to what extent management decisions and functions would need be performed by the External Auditor as it relates to the Governmental Entity contracting for the External Auditor's accounting services on the Capital Construction Program. The Examples provided by AU 220.01, Codification of Statements on Auditing Standards, clearly indicate that an external auditor who expresses an opinion on financial statements should avoid the appearance of a conflict of interest.
 - (b) There appears to be a conflict of interest whereby the subconsultant performs accounting services for the Governmental Entity while under the direction of the External Auditor, who may require the subconsultant to perform auditing services for the same accounting services provided by the subconsultant as it relates the Capital Construction Program. The examples provided by AU 220.01, Codification of Statements on Auditing Standards, indicate that a subconsultant auditor who performs auditing services on behalf of an external auditor that expresses an opinion on financial statements should avoid the appearance of a conflict of interest.
- (2) Second Potential Conflict: The second question for which we seek guidance concerns several other accounting firms (collectively, "Accounting Firm") that have responded to the County's solicitation.

Facts:

- (a) Accounting Firm has responded to the Governmental Entity's solicitation for accounting services for the Capital Construction Program and at the same time conducts business with one or more CCP Firms that are currently performing work for the Capital Construction Program. Accounting Firm does not provide external auditing services for the Governmental Entity as a whole or for any of its component entities. Accounting firm **does not express an opinion** on the financial statements of any CCP Firm involved in the Capital Construction Program. Rules of the State Board of Accountancy, Chapter 61H1-21.001 and 21.002, Independence and Integrity Standards, have been cited by the Accounting Firm.

- (b) Same facts as above except Accounting Firm **does express an opinion** on the financial statements of one or more CCP Firms.

Issues:

For purposes of section 473.315(1) and underlying interpretive rules, if any, and Section AU 220.01, if Accounting Firm is retained by the Governmental Entity to provide (i) project development, (ii) project financial controls, (iii) funding sources and uses, and (iv) contract review, auditing and closeout for the Capital Construction Program, would Accounting Firm be considered independent when it is also employed as an accountant by one or more CCP Firms that presently are under contract to provide services or work for the Capital Construction Program?

Conclusions:

- (a) Although the Accounting Firm is not expressing an opinion on the financial statements of any CCP Firm involved in the Capital Construction Program, the CCP Firms that are currently under contract with the Governmental Entity would be provided services by the Accounting Firm at the same time that the Accounting Firm is providing services directly to the Governmental Entity that are related to the Capital Construction Program. Based on the Relationships of the services provided by the Accounting Firm to both the CCP Firms and the Governmental Entity, concurrently, a conflict of interest exists. In addition, it appears there would be an internal control weakness if the same Accounting Firm provides services related to the Capital Construction Program for the Governmental Entity and also provides services related to the Capital Construction Program for one or more CCP Firms.
- (b) Here the Accounting Firm is expressing an opinion on the financial statements of one or more CCP Firms providing work or services for the Capital Construction Program. The analysis is the same as (a) above, and a conflict of interest would exist.

Please review the above and call me to discuss the issues if you have any questions or require further information. Thank you very much for your prompt attention to this matter.

Sincerely

N.W. Thabit
Commission Auditor