The smooth transition to a new audit firm

How public and private companies can avoid past problems and ensure future success
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A record number of companies have left relationships with audit firms in recent years — and the trend shows no signs of slowing.

Sarbanes-Oxley (SOX) regulations, which generated an unprecedented workload for large accounting firms, were a likely catalyst for much of this turnover.

Consumed by serving SEC clients, the largest firms had little time left for smaller clients — a priority shift that was not lost on these companies. Tiring of indifference from their auditors, many small and midsized companies found themselves looking for a new audit firm.

Also fueling audit firm turnover may be the dramatic upsurge in private equity takeovers. Private equity groups, which typically purchase companies to extract value, often inherit audit firm relationships. For a variety of reasons, the new owner often decides to hand pick a new auditor.

Changing audit firms: One company’s experience

Texas-based engine remanufacturing and distribution company AER had a long history with a large national accounting firm. About three years ago, the relationship’s equilibrium began to shift, says Chris Mantzuranis, CFO and executive vice president of AER.

External factors, such as consolidation of the Big Eight and intense demand for SOX compliance consulting, made it difficult for a leading accounting firm to effectively serve a family-owned business with $250 million in sales, says Mantzuranis.

Although the relationship remained affable, sticking points over fee schedules and AER’s deadline needs became more difficult to resolve. AER decided it was time to look for a new firm to handle its audit work.

“Our audit firm did everything it could to make our relationship work — and so did we,” says Mantzuranis. “But SEC companies had to be their [the accounting firm’s] priority. And we don’t have the same needs as those companies.”

As a privately owned business, AER was not required to meet SOX regulations, but it needed to provide its financial partners with an independent annual audit at the close of each fiscal year.

Mantzuranis says AER’s management team had a fairly clear idea of what they wanted in a new audit firm. One of their most important criteria was the national presence they’d grown accustomed to. “We didn’t want to give up that wealth of expertise and perspective on what’s happening at the federal level,” says Mantzuranis.

Other qualifications they sought included industry experience, price competitiveness and professionalism. “We were looking for good people and top-notch service,” says Mantzuranis. “And we wanted a firm that could do a good job for companies our size.”

Using management’s criteria to narrow the field of prospective candidates, Mantzuranis began researching
what he considered to be serious contenders for their business. Much of his focus was on firms’ client base and reputation. He eliminated additional firms based on his findings — and invited the final three to make presentations.

After meeting with top candidates and checking references, AER management decided to go with McGladrey & Pullen. Three years and three audits later, Mantzuranis says he is still pleased with the service AER receives. “Each year, McGladrey & Pullen meets our expectation of being treated like a brand new client,” says Mantzuranis.

“We’re not a company that likes to change service providers,” says Mantzuranis. “We took our time finding a new firm, and McGladrey & Pullen has done a great job for us.”

**Knowing what you want, don’t want — and shouldn’t worry about**

Having a basic idea of what you want and don’t want in an audit firm can help you streamline the selection process. It’s also important to decide which criteria are flexible, so you don’t arbitrarily eliminate a qualified firm from the running.

Companies that sever ties with their audit firms have typically become disenchanted due to factors like poor service, complacency and ever-increasing fees. It goes without saying they don’t want the problems they encountered with the last firm to recur with the new one.

But when relationships don’t work out, there are often lessons learned — as was the case with AER. Since its previous audit firm was a high performer in key areas, AER management was unwilling to settle for less. Knowing the value of a national office helped them rule out firms that couldn’t provide such resources.

Criteria such as industry experience can be important. But if your company is a distributor of electronics equipment, you’ll need to weigh whether the firm needs experience with distributors or if they need firsthand knowledge of your specific product. In most cases, general industry experience is transferable between product lines.

Once your audit committee or board has expressed its wishes, you’re ready to employ a thorough, diligent selection process. This next step will help ensure that underachieving firms don’t make the cut — and that the firm you choose meets your expectations.

**Timing your search**

Whether your deadline for filing audited financial statements is determined by a bank or the SEC, don’t cut it too close. If you plan to switch firms, you need to begin the transition process well before your next reporting deadline.

AER transitioned from its longtime firm while building in critical lead time for a new firm. This allowed McGladrey & Pullen to plan the audit under favorable conditions. It also facilitated a smooth handoff between the two firms.

**Selecting the right firm**

Taking the time to find the right audit firm will best serve companies — both public and private — in the long run and will significantly ease the transition process. Incorporating certain steps in your firm selection process is also critical.

Primary vehicles for learning about audit firms include research, face-to-face interviews and proposals submitted by the firms. Using these opportunities to their fullest advantage will help ensure that the audit firm you select is the best fit for your company.

**Use research to narrow the field**

Some companies issue a request for proposal to identify a field of interested candidates. This often generates a large number of proposals, but only a few from firms that meet the company’s qualifications.

To avoid piles of unnecessary paper and inefficient use of time, your audit committee may want to conduct due diligence research on a few firms that serve midsized companies. Information about firms’ clientele, industry focus and geographic presence may be available on Web sites or through marketing materials. Word-of-mouth recommendations from business associates can also be helpful.
Once firms with certain basic criteria are identified, the committee may want to research the following:

- Results of peer reviews
- Results of PCAOB review, if available
- Any media coverage related to the firm or its clients
- Reputation with the financial community

Firms that remain in the running after this step should be contacted for face-to-face meetings.

**Spend quality time**

In this stage of the decision-making process, members of the selection team should meet with representatives of three or four carefully selected firms.

These meetings are an opportunity to discuss issues that are critical to your company. Audit committee or selection team members should also confirm that firms:

- Have knowledge and experience applicable to your industry
- Want to work with companies your size and will value your business
- Have the resources, particularly at the partner level, to provide optimal service to your company
- Are available to begin working within your required timeframe

This is also a time to gain clear understanding of the firms’ fees, hours and audit preparation requirements. If you have business interests outside of the United States, ask about firms’ international capabilities.

**Consider the messenger**

Consider the level of rapport you feel with representatives from each firm. Factors such as likeability, sense of humor and communication skills are important in long-term relationships.

Be wary if the presentation isn’t professional, or the firm’s representatives seem like the B-team.

“If a firm doesn’t bring its best people to the interview, they are probably underselling you,” says Mantzuranis.

“McGladrey & Pullen came with experienced people who understood our needs. They demonstrated a level of professionalism we thought was appropriate, and it made an impression,” he says.

**Invite top picks to submit proposals**

By the time you are ready to invite proposals, the field of candidates should be small – and your spirits should be high. You are close to completing the most important step of the audit transition process.

Firms that truly want your business will respond to your request for proposal by the deadline. But to ensure that firms submit their best work, give them a reasonable amount of time to complete their proposals.

When you review the proposals, ensure that the responses are consistent with what you were told in the initial meeting. Pay particular attention to responses related to fee structure, level of partner attention and other key areas of concern.

Consider quality, completeness and level of detail when you rank the proposals.

**Final interviews**

Ask any remaining questions in the final interview. Provide the finalists with a date by which you hope to make a decision – and do your best to stick to it.

If the other stages of the selection process were thorough, audit committee members and other company stakeholders should be able to reach a consensus.

When company decision makers deliberate between two outstanding firms, fees often become the tie-breaking factor. In the interest of ensuring that the firm you hire is the best long-term fit, revisit other important qualifications as well, including industry experience, rapport and accessibility of partners.

Price was an “extremely important” consideration to AER, says Mantzuranis. But it wasn’t the most important factor. “McGladrey & Pullen had a competitive fee structure, but they were not the cheapest firm we met with,” he says. “In the end, our overall comfort level with McGladrey & Pullen is what swayed us.”
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Easing the transition

Some transition considerations will vary based on whether a company is publicly or privately owned. But regardless of ownership structure, companies encounter many similar challenges when changing audit firms — and most can benefit from taking certain measures.

Work with your former audit firm

Notify your audit firm that it is dismissed. Do this without burning any bridges — you’ll need its cooperation.

If your company is publicly owned, you’ll need consent to use its prior audit opinions. Inform your former audit firm promptly that you’ll need its consent for this. Make sure you understand the former firm’s time requirements and are clear on what you must do to ensure a timely completion of this task. Provide drafts of documents in accordance with your arrangements with the former auditor.

Waiting until the current opinion is nearly complete — and asking the old firm to expedite your request — can result in excessive charges and missed deadlines.

Your new audit firm will need access to audit work papers from past years, which usually requires visiting the old firm’s offices. Facilitate contact between the two firms when you have the opportunity.

Get your documents in a row

Even before your new audit firm gets down to business, you can take action to make the transition process as smooth as possible. Ask your audit firm for a list of documents it will need, so you can begin compiling them. You should also show your new firm the workpapers you provided to your former auditor.

Some documents your auditor will likely need include:

- Articles of incorporation
- Debt agreements
- Buy-sell agreements
- Significant leases
- Significant employee agreements
- Stock certificates
- IRS exams
- IRS filings
- SEC filings and correspondence

Designate enough resources to the audit

To help the audit run smoothly, you’ll need to enlist cooperation from within your company. Appoint the right people at the right levels to help ensure deadlines are met and that accurate data is provided.

People you may want to designate as audit resources include:

- Chief financial officer
- Controller
- Assistant controller
- Accounts receivable supervisor
- Accounts payable supervisor
- Internal auditor
- Director of accounting

Your company should also provide the name of a primary contact for audit-related questions and issues. The audit firm should do the same. These personnel usually have a key role in the audit, and they should be accessible and responsive.

Hold a kickoff meeting

Invite tax and audit personnel from the new firm to a kickoff meeting. Introduce them to everyone with whom they may have contact, including administrative personnel and company leadership. Provide a complete list of contact information.

Develop a joint audit plan

Work with the audit firm to develop a plan that identifies deadlines and materials needed to meet them. This is a good time to discuss weaknesses in your system, including any concerns about your reporting structure. Be honest in your assessment of your company’s strengths and weaknesses.
Don’t underestimate prep time
Underestimating audit preparation time is a common pitfall, and one that is best avoided. Missed deadlines or incomplete data disrupt the audit process and can result in additional billings and higher-than-expected costs.

As a precaution, make sure your staff can realistically meet any deadlines you set. If you’re in doubt about readiness, push the deadline back. In the end, it’s better to start the audit late than to derail in mid-process.

Be upfront about adjustments
The audit process should not result in adjustments. The need for adjustments signals problems within a company’s internal reporting process. If you believe adjustments to your audit will be necessary due to weaknesses in your control process, discuss this with your auditor as soon as possible.

Have realistic expectations
Your new audit firm will undoubtedly need some time to find its way around your company. But if you begin the transition process by selecting a firm that knows your industry and understands companies like yours, the lag time can be minimal.

Making well-considered decisions and securing your company’s cooperation will help you achieve a smooth transition – and a long relationship with an audit firm that’s the right fit for your company.

How McGladrey & Pullen can help
McGladrey & Pullen offers a tailored audit approach that reflects the specific needs of midsized companies.

When you work with us, you can expect a thorough, cost-efficient, independent audit, performed in a timely manner by experienced professionals. We hire talented people and invest in training and tools – including systems to ensure consistency, objectivity and accountability – that encourage strict compliance with professional standards.

We select your audit team members based on their experience and skill in your industry. Then your team identifies the best methodologies to achieve a reliable, independent audit that will help you improve efficiencies and plan more accurately for the future.

Our senior people are extensively involved in the audit process and actively communicate with your company’s leadership. We give clients regular face-to-face attention.

At McGladrey and Pullen, we demand compliance with the profession’s ethics and independence standards, and our 80-year history of operating at the highest level of integrity and objectivity confirms our commitment to excellence. We are proud of our profession and strive to deliver on our promises to the public trust.

About the author
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Roger Hendren has more than 26 years of experience in the manufacturing, retail and distribution industries. His strengths include working with public and closely held businesses in the areas of general business advice; personal and corporate tax planning strategies; strategic planning; mergers, acquisitions and recapitalizations; financing assistance; and transferring a business to the next generation or to new management. Hendren has a Bachelor of Science in accounting from Northwest Missouri State University.

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