Manning Accounting and Consulting Services, LLC
MACS

May 15, 2024

Joseph M. Maestas, P.E., State Auditor
State of New Mexico, Office of the State Auditor
2540 Camino Edward Ortiz, Suite A
Santa Fe, New Mexico 87507

Re: Public Comment on 2024's Notice of Changes to the State Audit Rule

We have reviewed the proposed changes to the 2024 audit rule. As a small firm, we have several issues we would like to raise with the proposed change in the rotation rule from eight (8) years to six (6) years. We sent a previous response dated March 11, 2024 of which we still believe are relevant and have not been addressed.

After the Office of the State Auditor (OSA) received many responses regarding this change, all of which appeared to be opposed to the change, the OSA cancelled the hearing and stated that "the auditor rotation rule will not change this year, and any succeeding changes to the audit rule will contain transition information to ensure entities have sufficient time to make any changes." The OSA then released a new proposal for this rotation rule change on April 23, 2024, with no real significant changes to the rule previously proposed. We will provide additional responses to this proposed change, which we do oppose.

The supposed "transition rule" is not a legitimate transition. We specialize in school district audits with a secondary concentration in audits/AUPs related to domestic water/ditch associations. School districts have to make their selections by May 1 of each year. The OSA came out with a proposed rule change one week prior to when districts had to make their selections. The bidding process was over by that time. Therefore, no auditor could make adjustments to their audit load or now go out and try to get additional audits because the OSA is going to arbitrarily reject audits that were already in the revenue stream projections for 2025 and 2026.

The proposed transition rule spoke of "four-year cycles." There are no four-year audit proposals. While the rule allows for eight years, all of the OSA language and information reported to the OSA is still based upon three-year cycles, which is what school districts still bid. By waiting until entities already had to be in the completion phase of their selection process for the current year, the OSA also prevented them from doing a new two- to four-year proposal (since it appears the OSA would have been fine with a four-year proposal) which would have allowed them to maintain the audit firms they had and wanted to maintain until the end of the current eight-year cycle. Many entities would have done this had this proposed rule change been proposed in early March instead of late April. As such, the OSA did not allow a true transition for those in three-year cycles, the normal cycle for audits.

This change, if enacted, could be devastating for our firm, and potentially other firms in our situation. Under the eight-year rotation rule, we anticipated losing 4.9% of our current school district revenue in 2025, 7.2% in 2026, and 26.8% in 2027, which is when each of those districts would hit eight years. We would now lose 38.8% of this revenue next year. There is also an additional 28.5% of revenue that is back out to bid in the three-year cycle next year, meaning we could lose over two-thirds of our primary governmental revenue in one year. We moved from a managed transition to a cliff.

No sane business owner is going to put themself in this type of a situation voluntarily. What would the OSA look at doing if the legislature indicated they were considering cutting your funding by two-thirds?

As the owner of a small firm, it appears that governing agencies we are subject to – AICPA, GASB, and now the OSA – are doing everything in their powers to see that small accounting firms are pushed out of the governmental accounting area. The State has experienced a significant consolidation of firms in the past ten years. We believe this is just going to help accelerate this consolidation.

Let's look at what that consolidation looks like between 2014 and 2023.

2014 State Audit Information					
Classification	# of Firms	Audits Performed	% of Audits	$ Value of Audits	% of $ Value
KPMG	1	2	0.4%	$1,237,630	6.4%
21+ Audits	6	186	38.8%	$11,312,338	58.1%
11-20 Audits	7	92	19.2%	$2,179,450	11.2%
6-10 Audits	17	130	27.1%	$3,182,564	16.3%
1-5 Audits	30	69	14.4%	$1,569,489	8.1%
Totals	61	479	100.0%	$19,481,471	100.0%

2023 State Audit Information					
Classification	# of Firms	Audits Performed	% of Audits	$ Value of Audits	% of $ Value
KPMG	1	1	0.2%	$1,204,645	5.0%
REDW, LLC	1	2	0.4%	$539,303	2.2%
21+ Audits	12	346	71.0%	$19,251,200	79.1%
11-20 Audits	3	49	10.1%	$1,167,313	4.8%
6-10 Audits	6	49	10.1%	$1,027,820	4.2%
1-5 Audits	12	40	8.2%	$1,144,875	4.7%
Totals	35	487	100.0%	$24,335,156	100.0%

In 2014, there were 72 approved audit firms of which 61 did audits. In 2023, there were 54 approved audit firms of which only 35 did audits. The number of audits and the value of those audits has increased significantly in those nine years at the top.

Small firms are being pushed out. In 2014, 47 firms did 10 or fewer audits which accounted for 41.5% of the audits and 24.4% of the value of those audits. In 2023, only 18 firms did 10 or fewer audits which accounted for 18.3% of the audits and only 8.9% of the value of those audits. At the same time, firms doing 21 plus audits, or a few specialized large audits, went from 7 firms performing 39.2% of the audits and 64.5% of the value of the audits to 14 firms doing 71.6% of the audits and 86.3% of the value of those audits.

In 2014, the audit rotation rule was 12 years for audits of $60,000 or less (421 audits) and 6 years for audits over $60,000 (58 audits). In 2023, the rotation rule was eight years, and now you are proposing going down to six years with an abrupt change in how audits would be grandfathered for the previous eight-year cycle. While you may not agree, we do believe this will lead to additional consolidation.

Our firm must now seriously consider transitioning a large portion of our time to non-profit audits. We do a few audits in this area but have declined many opportunities to do other non-profit audits as we prefer where we have concentrated our time with school district audits. Our five-member on-site audit team has hundreds of combined school district audits under our belts, not something most audit teams can claim. However, we're not sure that really matters now.

We have heard no good explanation as to why the OSA believes that a six-year rotation rule is needed over the current eight-year rotation (twelve years was probably too long and six years is probably too short for a mandate). It can't really be justified on independence issues because that isn't an issue at eight years. Even the Sarbanes-Oxley rotation rules only require audit partners to rotate at seven years, not firms, for companies subject to the Securities and Exchange Commission.

A short rotation rule history: In 2014, the rule was the aforementioned twelve-year or six-year cycle depending on value. In 2016, this changed to a straight six-year cycle with a transition which gave until 2018 to complete. In 2021, the rotation rule was changed to the current eight-year rule. Now, in 2024 the OSA is proposing going back to the six-year rule. Four different rotation rules in an eight-year period does not instill confidence in the decision process at the OSA.

Being blunt, this seems to be one of three things; 1) it's political; we change personnel in the OSA and they must put their stamp on the Audit Rule; 2) making abrupt changes, especially downward in the rotation rule, seems to lead to further consolidation so the OSA has to deal with fewer firms; 3) or it's as simple as "because we can".

We hope that the Office of the State Auditor consider the issues we have raised with the proposed change of the audit rotation rule from eight years to six years.

We thank you for this opportunity to comment on these proposed changes.

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