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# Tentative description of the nature of management advisory services by independent accounting firms; Statement on management advisory services 1

American Institute of Certified Public Accountants. Committee on Management Services

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# STATEMENT ON MANAGEMENT ADVISORY SERVICES

FEBRUARY 1969

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## *Tentative Description of the Nature of Management Advisory Services By Independent Accounting Firms*

### **Introduction**

1. An independent accounting firm's purpose in engaging in management advisory services is to utilize the essential qualifications it has available to provide advice and technical assistance which will enable client management to conduct its affairs more effectively. These essential qualifications are based in part on attributes acquired in conducting other aspects of practice and include technical competence; familiarity with the client's finance and control systems and his business problems; analytical ability and experience in problem solution; professional independence, objectivity and integrity. Although not always identified as "management advisory services," independent accounting firms have rendered advice and assistance to clients outside the accounting, auditing and tax areas for as long as the accounting profession has existed.

The role of an independent accounting firm in performing management advisory services is to provide advice and technical assistance, and should provide for client participation in the analytical approach and process. Specifying this as the proper role recognizes both the appropriate place of management advisory services and the realities of practice. This is the only basis on which the work should be done and it is the only basis on which responsible management should permit it to be done.

*Issued by the Committee on Management Services  
American Institute of Certified Public Accountants*

When the services to a client also include expression of an opinion on the fairness of financial statements, the matter of role has special significance, since it also relates to the independence of the accounting firm. Opinion 12 of the American Institute of Certified Public Accountant's Committee on Professional Ethics is explicit on this point. The accounting firm's role is to provide advice and technical assistance and to avoid making management decisions or taking positions that might impair the firm's objectivity.

2. In recent years, management advisory services have been in an accelerating process of evolution, with the profession's participation growing in response to requests from clients for assistance. In many instances, management needs and problems are more complex and the techniques involved in their solution more sophisticated than ever before. The profession's response to the demand for advice has been to develop a broader range of services.

3. The American Institute of Certified Public Accountants set forth the Institute's basic policy regarding management advisory services in the following resolution adopted by Council in April, 1961:

"It is an objective of the Institute recognizing that management services activities are a proper function of CPAs, to encourage all CPAs to perform the entire range of management services consistent with their professional competence, ethical standards, and responsibility."

The Committee on Management Services believes that an interpretation of the phrase "the entire range of management services consistent with their professional competence, ethical standards, and responsibility," will contribute to the orderly implementation of this policy throughout the profession.

Subsequently, Council, in October 1966, adopted "A Description of the Professional Practice of Certified Public Accountants." Within the framework of this description, the committee believes that a further description of that portion of the practice generally referred to as management advisory service is desirable. Such an interpretation and further description will, among other things, serve to:

- a. Guide independent accounting firms in selecting and practicing in areas of service in which they can and wish to render advice and technical assistance to clients beyond those relating to auditing, financial accounting, and taxes;
- b. Assist those responsible for developing and conducting educational programs for CPAs;
- c. Provide a basis for the general business community to become better informed regarding the nature of management advisory services as performed by independent accounting firms.

### **Description of Management Advisory Services**

4. Management advisory services by independent accounting firms can be described as the function of providing professional advisory (consulting) services, the primary purpose of which is to improve the client's use of its capabilities and resources to achieve the objectives of the organization. This can relate to areas such as:

- The management functions of analysis, planning, organizing, and controlling
- The introduction of new ideas, concepts, and methods to management
- The improvement of policies, procedures, systems, methods, and organizational relationships
- The application and use of managerial accounting, control systems, data processing, and mathematical techniques and methods, and
- The conduct of special studies, preparation of recommendations, development of plans and programs, and provision of advice and technical assistance in their implementation.

In providing this advisory service, the independent accounting firm applies an analytical approach and process which typically involve:

- Ascertaining the pertinent facts and circumstances
- Seeking and identifying objectives

- Defining the problem or opportunity for improvement
- Evaluating and determining possible solutions, and
- Presenting findings and recommendations,

and following the client's decisions to proceed, the independent accounting firm may also be involved in:

- Planning and scheduling actions to achieve the desired results, and
- Advising and providing technical assistance in implementing,

in combination with knowledge and experience in such areas as:

- Organization and management methods
- Office and management functions
- Systems and procedures
- Data processing methods
- Quantitative methods (mathematics, statistics, etc.), and
- Financial management,

to produce solutions such as:

- A management information system
- A sales reporting system
- A cost accounting system
- A work measurement program
- Improved production control
- An organization plan with statements of duties and responsibilities, or
- An electronic data processing system.

5. The above represents a conceptual description of management advisory services rather than a definition in terms of area of application of the services. The committee believes that the adoption of an itemized "list of acceptable areas of service" would be useful; however, no generally accepted classification of subject matter currently exists for this purpose. Also, the validity and acceptability of such a list would have to be dependent on there being clearly discernible criteria for differentiating among the range of possible subject matter, and no such precise bases have yet been found.

There are several further reasons why the development of such

a list appears to be unattainable. In the first place, many of the subject areas themselves do not have definitions which are precise and exclusive enough to be usable or acceptable in preparing the list. Second, the decisions regarding many of the subject areas, as being an "acceptable area of service," could depend on considerations of the underlying subareas with which the independent accounting firm was concerned (e.g., research per se vs. a system for the planning and control of manpower participating in research). Third, the circumstances under which services are to be rendered in a particular subject area (a large vs. small client; a simple vs. complex problem) and the role of the independent accounting firm (as a fact-gatherer vs. a recommender vs. a technical implementor) would also be pertinent in the determination of the list.

### **Determining A Scope of Service**

6. The committee believes that an independent accounting firm in reaching a decision as to the scope of its management advisory services should be guided by certain significant criteria established by the profession, such as competence and independence. Certain criteria will apply primarily to the profession as a whole, while others will be more relevant to the particular independent accounting firm or engagement.

7. The CPA's ability to learn and successfully apply the basic analytical approach and process is well recognized. The more difficult questions which must be answered by an independent accounting firm in determining a scope of management advisory services, however, relate to the depth of knowledge and experience required in the various subject areas and kinds of problems and solutions with which the firm might become involved. Since it is not possible to specify all the subject areas and types of problems with which independent accounting firms may be called upon to deal, the committee suggests the following guidelines which should be useful in selecting a scope of services.

### **General Guidelines**

8. *Responsibility to Establish Scope of Services*—Each independent accounting firm has the responsibility to determine the

scope of services it is competent to offer to the public, subject to the pronouncements of the profession. Each independent accounting firm should make its own decisions in accordance with the type of practice which it desires to conduct. It is anticipated that many firms will not choose to render management advisory services in all subject areas.

9. *Independence*—When providing management advisory services, the independent accounting firm must, as in all areas of practice, give particular consideration to both independence and the appearance of independence as set forth in the Code of Professional Ethics particularly in Rule 1.01. This rule states in part:

“Neither a member or associate, nor a firm of which he is a partner, shall express an opinion on financial statements of any enterprise unless he and his firm are in fact independent with respect to such enterprise.

“Independence is not susceptible of precise definition, but is an expression of the professional integrity of the individual. A member or associate, before expressing his opinion on financial statements, has the responsibility of assessing his relationships with an enterprise to determine whether, in the circumstances, he might expect his opinion to be considered independent, objective and unbiased by one who had knowledge of all the facts.”

In addition, the Committee on Professional Ethics concludes with the following statement in its Opinion No. 12:

“The committee does not intend to suggest . . . that the rendering of professional services other than the independent audit itself would suggest to a reasonable observer a conflict of interest. . . . In the areas of management advisory services . . ., so long as the CPA’s services consist of advice and technical assistance, the committee can discern no likelihood of a conflict of interest arising from such services. It is a rare instance for management to surrender its responsibility to make management decisions. However, should a member make such decisions on matters affecting the company’s financial position or results of operations, it would appear that his objectivity as independent auditor of the company’s financial statements might well be impaired.

Consequently, such situations should be avoided.

“In summary, it is the opinion of the committee [on Professional Ethics] that there is no ethical reason why a member or associate may not properly perform professional services for clients in areas of . . . management advisory services, and at the same time serve the same client as independent auditor, so long as he does not make management decisions or take positions which might impair that objectivity.”

10. *Competence*—The scope of management advisory services of an independent accounting firm also depends on another fundamental and obvious matter—competence. Independent accounting firms have the responsibility to evaluate their ability to render management advisory services of a professional quality in each specific area. They also have the responsibility to refrain from representing themselves as qualified and willing to accept work in areas where they do not possess the required competence. Competence in professional work involves both the technical qualifications of staff personnel and the firm’s ability to supervise and evaluate the quality of the work performed. Competence embraces both the analytical approach and process and the subject matter of the area involved.

The degree of competence required will naturally vary according to the degree of difficulty of the engagement and the importance of the recommendations for which the independent accounting firm will assume responsibility. It will also vary according to the role assumed by the firm—i.e., as an advisor, fact-gatherer or technical implementor.

The independent accounting firm will not always begin an engagement with a full and detailed knowledge of the characteristics of the business or of all of the techniques available for the solution of the problem, for no two situations faced by a firm are ever exactly the same, nor are the technical procedures required to achieve the desired result identical. The firm is expected to adapt its procedures and knowledge to the circumstances of the particular case and to research unfamiliar subject matter involved in the solution of the problem. In those instances in which the acquisition of the necessary knowledge is not a natural part of the conduct of the engagement as a result of the

fact-gathering procedure or of the normal research process, the independent accounting firm should question its competence to carry out the engagement.

This matter is considered more fully in Statements on Management Advisory Services No. 2, *Competence in Management Advisory Services*.

11. *Other Considerations*—The scope of management advisory services is such that no one person can be expected to develop sufficient specialized knowledge and skill in all areas in which clients might require assistance. A wide range of management advisory services can normally be performed only by a firm which includes both generalists and individuals who have acquired specialized qualifications in the subject matters or techniques involved. Accordingly, the requirements for specialization in certain areas may limit the scope of management advisory services offered by any given independent accounting firm. As a result, many independent accounting firms will decide on a scope of practice which does not include areas of service offered by others in the profession.

The scope of services offered by the independent accounting firm also should be adequate to identify and resolve the clients' basic problems and not just problem symptoms. If the scope is excessively narrow, there is a danger that the problem may be defined and solutions developed from too narrow a point of view to be really useful to the client.

12. *Referrals*—Referral of management advisory services work to other independent accounting firms is an alternative course of action to that of developing individual or firm capability. Recognizing the depth and breadth of skills required to deal effectively with the clients' basic problems and the economic limits of practice, the independent accounting firm's sense of responsibility to its clients may in some or all instances lead it to refer the management advisory services requirements of its clients to others. The referral arrangement may provide for a joint effort or provide for the services to be performed solely by the referee brought in for that purpose. In any event, to the extent that the independent accounting firm finds an effective way to cooperate with others, it may thereby expand its own

knowledge and extend its own scope of service toward providing the full range of management advisory services.

13. *The Code of Professional Ethics*—The applicability of the Code of Professional Ethics to management advisory services was clarified by Opinion No. 14 of the American Institute of Certified Public Accountant's Committee on Professional Ethics which states, "... It is the opinion of the committee that all provisions of the Code of Professional Ethics apply to management advisory services, except those rules solely applicable to the expression of an opinion on financial statements." It is, therefore, the responsibility of the independent accounting firm to assure itself that the nature and scope of the management advisory services it elects to offer are in conformity with this requirement.

### **Conclusion**

14. The American Institute of Certified Public Accountants, recognizing the needs of the business public and the long record of substantial and varied accomplishments by independent accounting firms in rendering management advisory services, has encouraged and continues to encourage firms to develop capabilities in this field.

The appropriate range of services for the profession and the accounting firm should depend on considerations of:

- Responsibility of the independent accounting firm to establish its scope of services
- Independence
- Competence
- Requirements for specialization
- Attention to the client's basic problems
- Referral arrangements, and
- The Code of Professional Ethics.

This statement has described the nature of management advisory services by independent accounting firms and is intended to provide guidelines for determining a scope of service and to serve as a basis for future statements in this area of practice.

*The Statement entitled "Tentative Description of the Nature of Management Advisory Services by Independent Accounting Firms" was adopted by the assenting votes of nineteen members of the committee. One member, Mr. Carrico, dissented.*

*Mr. Carrico dissents because he feels the Statement does not provide the needed delineation of proper scope of CPA practice in the management services area.*

*He believes that the CPA should limit himself to areas of practice which would be pertinent to management information and control systems based largely on accounting, economic and other pertinent data. This would also include procedural, data processing and organizational assistance necessary for the effective development and utilization of such information.*

#### **NOTES**

*This Statement is published for the guidance of members of the Institute in carrying out a management advisory services practice. It represents the considered opinion of the Committee on Management Services and, as such, contains the best thought of the profession as to the best practices. Members should be aware that they may be called upon to justify departures from the Committee recommendations.*

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