Practicing CPA, vol. 24 no. 8, October 2000

American Institute of Certified Public Accountants (AICPA)
CONsolidation and the Medium-Sized Firm

There is little doubt consolidation in the accounting profession will continue. You cannot pick up an industry publication without reading about two firms merging. The players may change, but in reality, it doesn’t make too much difference who they are (banks, local accounting firms, regional accounting firms, or financial services firms). The underlying reasons for consolidation are still the same—a fragmented industry, no existing strong brand name, a rising requirement for capital, too many unfunded retirement plans, and poorly thought-out succession plans, to name a few.

Even though publicly held companies won’t acquire most firms, most firms will eventually feel the impact of the consolidation movement. The question that firms should be asking themselves is, “What should we do to prepare for the future in this ever-changing environment?”

Prepare for the future

No one can tell you how the consolidation movement will affect your firm, how your current business model will change, what your future mix of services and products will be, or what you should ultimately do. However, certain issues indicate what the future may look like and what problems you may face. If you want to prepare your firm for consolidation or just for long-term survival, you need to pay attention to certain areas that, if not fixed, can cause your firm serious future problems. Eleven of these issues follow, along with questions to help you identify whether each problem exists in your firm. Start resolving these issues now!

1. Partner issues. Partner issues are perhaps the biggest area that can cause your firm future problems. Do you have many partners near retirement? Will you have unfunded retirement problems? Are there founding partners who will retire with huge retirement liabilities? Will you be losing key partners? Will this cause client retention problems? What are the current unfunded retirement liabilities? What are the skill levels and entrepreneurial talents of younger partners? Are there partner compatibility issues? Prima donnas? Are
there partner productivity problems? Do you have a managing partner who “knows it all”? Do you have partners who have retired but have failed to tell anyone yet?

2. **Service/product line issues.** Balancing which services and products to offer is next in line to cause problems in your firm. Are you still a traditional accounting firm? Are you offering financial services? What new services have you added in the last three to five years? What strategic alliances have you formed in the last three to five years? How many non-CPAs are shareholders in your firm?

3. **Service quality issues.** Service quality often becomes a serious problem for firms. Is client turnover in excess of 5 percent to 10 percent? How do you listen to what your clients are telling you? (For that matter, do you even listen to your clients?) Do you conduct frequent client satisfaction surveys?

4. **Staffing issues.** Every firm today is having problems finding staff, but if you are unable to keep staff, start understanding why. What are you doing to alleviate the problem? What is your staff turnover? What is the cause for it (planned or unplanned)?

5. **Managing partner or other partners not letting go.** One of the hardest things is for partners to let others in the firm take responsibility. The more you give up, the more your firm will grow. Do you have a founding partner who has let a younger partner assume the title of managing partner but gives him or her no responsibility or authority to act?

6. **Little or no marketing.** Firms experiencing minimal internal growth can often trace it to this issue. Do you have a marketing plan? Is someone responsible for overall management of the marketing area? Are you improving the client base—that is, are you getting bigger, better, faster-paying clients, with higher-priced engagements?

7. **Geographic location.** This is an often overlooked issue. Are you in a stagnant or shrinking market? What is the long-term trend in your area?

8. **Monthly performance reports.** If you are not managing by the numbers, you will have serious problems. Is your financial information accurate? Do your reports come out late each month? Are you doing annual budgets and forecasts?

9. **Aspiration planning.** If you have no plan, someone else will decide for you. Don’t wait for someone else to tell you what to do. Do you know what you want your position in the future to look like?

10. **Implementation.** Some firms are great at developing killer strategies but cannot do anything with them. Planning is good, but it’s all in the implementation. Does your firm have a difficult time implementing its ideas?

11. **Leadership.** Lack of leadership is ultimately the number one firm killer. Now is the time to develop future leaders, not when the current leaders are ready to retire. Do your firm’s leaders help others succeed? Does your firm have a succession plan?

**What to do now**

The areas just listed are in your span of control. You simply need to make decisions about what you want to do. To help you decide what you should do in the future, you need to start paying attention to the changes that are taking place around you and learn how to read them. Now is the time to take off the blinders and quit telling yourself that changes will never happen in the accounting profession, because they are happening and will continue to happen. Here are some suggestions on how to stay ahead of the curve.

1. **Learn to live outside of the box.** Thinking outside of the box is okay, but you need to live outside of the box. Remember, success comes from effective implementation. Action, not thoughts, makes things happen.

2. **Address your worse nightmare.** Whatever you fear might happen to your firm, will—so it’s important to listen to your gut feelings and then do something about it.

3. **Challenge everything you do.** It’s time to become a child again and ask, “Why?”
4. Read everything that is business related. You should especially focus on new e-commerce publications, such as Red Herring, WIRED, and Upfront.

5. Follow trends that are affecting your clients. If a trend affects your client, it also affects your firm. In a recent Time Magazine article (May 22, 2000), Tom Peters predicted that most white-collar jobs would change or disappear in the next ten years, just like the blue-collar jobs. He is talking not only about a lot of our clients; he is also talking about us.

6. Stay current with technology: Technology is here to stay, and it will continue to expand the reach and depth of information that will be available to everyone. As this information becomes more available, its price in the market goes down. Think about analysts’ research reports on various companies. As reports have become available to nearly everyone, their cost has come down to zero in some cases.

7. Recognize that knowledge will spread within and without our firms. The firm of the future will empower the individual through training, education, and expertise. We will see automated work groups and work group collaboration. This will lead to an integrated enterprise in which enterprise knowledge will be shared and managed.

8. Understand the concept of market space. Market space, not marketplace, will take over the value chain. Michael Porter created the term value chain several years ago. The value chain was the complex web of links between an organization and its suppliers, sales force, purchasing and distribution channels, clients, and customers. Traditionally businesses have benefited from enhancing and integrating the links. In the future, the central repository of enterprise value will no longer be a chain but a space. This is the market space.

Survival checklist
Someone once said that the future is what you make of it. With that thought in mind, your partner group should meet to discuss future options, such as a merger, and consider the following list of questions to determine your firm’s future.

- What do we want to be as a firm? Many partner groups are afraid to discuss change. They are afraid to upset the cart. Don’t be afraid to face your fears.
- Why would our firm want to be part of a consolidator? Don’t put money at the top of your list.
- Why would a consolidator want our firm? Do you have a niche practice? Would you be considered to be the lead firm in the area? Does your firm have great leaders?
- Would our firm cultures mix?
- Can we live without having ultimate control?
- Do we know all there is to know about the consolidator and what it intends to do with our practice?
- Do we have problems in the firm that need to be resolved? They are not going to go away just because you are acquired. The acquisition, however, can help you resolve issues that you were afraid to address before.

Your options
Basically, firms have eight options in today’s environment.

1. Sell your practice. This permits you to: translate the value of your practice into dollars; continue to practice; gain scale, which will make it easier for you to compete against larger firms; have access to greater amounts of capital; offer better benefits, which helps retain and recruit staff; and provide more mobility and career opportunities. You do, however, lose ultimate control of your practice.

2. Merge upstream. Limited options exist for the medium and large local firms today because there are only a few regional firms with which they could merge. These transactions normally do not let you translate the value of your practice into dollars, and you still lose most control over your practice.

3. Merge with an equal. Many firms today are joining with firms of similar size. This can make sense, provided that the merger brings about some synergies. Just make sure that one plus one equals three. Bringing two weak firms together does not make one strong firm.

4. Stand alone. You believe that you have the talent and resources to remain as you are. Just make sure you develop a realistic strategy for independence and success.

5. Develop a multidisciplinary practice. These are new entities that are beginning to appear. Ernst & Young financed McKee, Nelson, Ernst & Young, a Washington, DC, law firm. Some states and the District of Columbia now allow law and accounting firms to share revenues. This combination, added to financial services, would truly create a one-stop shopping entity.

6. Become a consolidator locally. Because many smaller firms look to larger firms to provide them with more services and better service quality, you could become a consolidator of sorts on a local basis. Small firm owners are looking for secured retirement payments. In exchange, you get additional clients and staff, and if you know how to expand services, you add dollars to your bottom line.

continued on page 4
7. Create strategic alliances through networks and associations. New networks and associations are being developed every day. Such associations often provide a national and international coverage, financial services and products capabilities, marketing, management, and other shared utilities.

8. Do nothing. If you decide to do nothing, you have given up and will eventually go out of business. This is not a viable option.

Conclusion
As you can see, the future is in your hands and there will always be a lot of options for those who have a vision and direction. Make sure your firm has a vision and everyone knows what it is. Don't be afraid to make changes and, sometimes, hard decisions as you move forward.

—By August J. Aquila, Ph.D., an internationally known consultant, speaker, and author in the accounting profession. He is currently vice president, Mergers & Acquisitions, at American Express Tax and Business Services Inc. He can be reached at aaquila@worldnet.att.net. Aquila is the author of the AICPA publication Breaking the Paradigm: New Approaches to Pricing Accounting Services (product number 090401PC10). For information call (888) 777-7077 or visit www.aicpa.org.

THE GRAVEYARD OF STRATEGIC PLANS

The following article appeared in David Cottle's Key Points (Summer 2000) and is reprinted with permission.

Strategic planning has been fashionable for accounting firms for years. A subject search for "strategic planning" at Amazon.com turned up 1,270 books.

I have helped firms plan strategy for more than 20 years. To prepare for these sessions I first review the minutes of the last strategy retreat. Then I ask the managing partner the status of the various strategic initiatives on which they worked so hard and diligently. Often, most of the planned initiatives were never implemented. Why?

It wasn't because the plans were no good. The plans themselves are typically well thought out and (coming from accountants) well documented. These plans usually include the required who, what, when, and how. Yet the plans never got done.

Most CPAs think a successful plan means "come up with the right list of things to do." In other words, their focus is on "strategy."

However, if the result of successful planning is actually getting things done, then those plans were failures.

Key point. Developing a plan to achieve a goal or solve a problem is not enough. I would even say that the problem-solving part of planning is often the easiest part.

Partners at a strategic planning retreat often feel that designing the right action plan is the most important part of the retreat. Yet, as I noted earlier, most of these well-designed action plans did not result in action. Why?

It wasn't for lack of commitment. When I interviewed the partners, they usually supported the plans and thought they would achieve the stated goals.

These plans usually included the required budgets and time tables. Yet the plans never got done. Why?

The answer
We've all heard the old adage, "If you want something done, give it to a busy person." The theory is that people who are always busy are productive and, therefore, they can always add one more item to their to-do list.

But, as the old song says, "It ain't necessarily so."

In fact, that's why most action plans end in the graveyard—they are assigned to people who are already working at full capacity. They are just too busy.

How to make strategic planning work
Successful strategy is more about implementation than about plan design.

Key point. A well-designed strategy is useless unless implemented.

Most of the value of planning comes from figuring out how to make things happen. It is not so much about what you should do (often you already know that) as about how to get it done. Strategy should establish investment priorities. And the scarcest resource most firms have to invest is the time of their partners.

Since most partners already work 50- to 60-hour weeks, when are they going to find time to take on a new activity? They aren't. Unless, at the same time we ask them to assume a new responsibility, we relieve them of an old one. In other words, we must help the designated person by freeing up sufficient time for them to perform the new tasks.

How? Look at their current responsibilities. If any of their current responsibilities are less important than the new one, make them delegate the old area to someone else.

"But, Dave, we're light at the management level. We don't have anybody else to whom we could delegate that area." Too bad. If you want the new project done, you're going to have to choose.

The supply of time for your current people is totally inelastic. No matter how much you or they want more time, no matter how much you would pay for one more hour a day, your company's supply (unless you hire more people) is the same. Moreover, time is 100 percent perishable and cannot
be stored. Any time that your people do not use well is gone forever and will never come back. Partner and manager time will always be in exceedingly short supply.

The problem is not the limited time you have (after all, we all have 24 hours each day); it is the almost limitless options your executives have about what they will put into each day. Everywhere they turn, executives make decisions about what to do. And choosing one thing means deferring all others.

Just remember that the object is not merely to set priorities. That is a relatively easy mental exercise; everybody can do it because it takes little energy or self-control. The reason why so few people focus their energy is the difficulty of setting what Peter Drucker called posteriorities—that is, deciding what tasks not to tackle—and of sticking to the decision. As Drucker so astutely observed: “What one postpones, one actually abandons.”

Don’t ask, Who can best handle this responsibility? All too often, it is a person whose time is very valuable and scarce. (That is why their time is valuable and scarce.) Instead, ask: Who should handle this responsibility? And try to get tasks delegated down to the least expensive person that can adequately perform.

Partners often unconsciously give priority to current projects and responsibilities over new ones. The old projects are familiar and comfortable. They thus relegate work on new assignments to second preference. This means that, while all old responsibilities get done, important new tasks are often delayed, or as Drucker observed, even abandoned.

Why should you set priorities and posteriorities? Because not all of your new action plans or current responsibilities are of equal value. And some listed items depend on completion of other listed items.

This broader view of strategic planning consists of—

- Determining objectives (or identifying problems).
- Gathering relevant data.
- Defining obstacles and opportunities.
- Evaluating alternatives.
- Formulating recommended actions, including: the person responsible, budget, timetable, and what current tasks to delegate or abandon.
- Communicating results to interested team members.
- Implementing the actions finally determined.
- Following up to make sure the action plans are in fact implemented. ✓

---

**NEW MAP PUBLICATION!**

**Double Digit Growth: Tools From Top Firms**

*By Jean Marie Caragher*

The twelve firms profiled have had double digit growth annually for the past three years, excluding mergers. Find out how they accomplished this, what tools they used, and what processes were implemented. See how they've grown and take away a thorough understanding of each firm's "secret formula" for success.

This unique publication gives you:

- Practical advice and brainstorming ideas
- Access to your peer’s experiences and knowledge
- Marketing and management program ideas

To order, call (888) 777-7077.

Product number: 090465PC10

Member price: $36.00

Nonmember price: $45.00

Prices do not include tax, shipping, and handling.

---

**WHAT A TANGLED WEB**

The technology revolution is here and is transforming the way business is transacted. The accounting profession is not immune from this transformation. One of the most challenging areas that practitioners face is assisting Web-based companies. According to the AICPA’s top-ten list of technology concerns, the top technical issues for accounting, auditing, and assurance services that practitioners will face in the future are: security and controls, e-commerce, auditing electronic evidence, and the training and technological competency of auditing staff. Even small practitioners will have to become familiar with procedures and programs for auditing transactions and testing internal controls, through the computer, rather than around the computer. The concerns of practitioners with clients that are Web-based companies are many. Four main concerns include Web site valuation, Web site costs, going-concern issues, and security of Web-based transactions.

**Web site valuations**

Web site valuations have completely broken all ties with past valuation assumptions. Web-based companies are not valued on net earnings, capitalization, or net tangible assets. The only component taken into consideration is revenues (if applicable) or potential loss of revenues. Web sites can be valued as high as 50 times revenues, even though the company may have consistent losses, negative cash flow from operations, negative net worth, and few tangible assets.

*continued on page 6*
The main reason for this form of valuation is the unique factors a Web site offers: instant globalization, a broader spectrum of consumers, and the fact that consumers feel a closer and quicker communication link with the company. A properly developed and user-friendly site is more of an attraction than traditional window shopping (and physically less exhaustive). “Surfers” are drawn by interaction and eye-catching “bells and whistles”; they will spend more time and money at sites that catch their attention. The biggest advantage to developing a versatile site is that one site can handle multiple, diverse inquiries at one time, unlike a store employee. In addition, the development of a Web site can be a cost-effective approach to expanding a business and may also help a company realize cost-efficiencies in other areas (for example, distribution, warehousing, selling expenses, and location of facilities). The ability to expand business is phenomenal, as is the return on investment. It is not unusual for a $200,000 investment in a Web site to yield a 300 percent return.

Web site costs
The first assumption that has to be made is whether the cost of a Web site is capitalizable. The consensus of the Emerging Issues Task Force (EITF), at the March 2000 meeting regarding this issue, is that, under Financial Accounting Standards Board (FASB) Concepts Statement No. 6, Elements of Financial Statements, certain costs incurred in the development of a Web site should be capitalized. Web site costs, like the cost of most fixed assets, can be segregated into distinct groups: planning, development (construction or acquisition), graphics and content (lighting, furniture, and filing system), and the operating stage.

According to the EITF, those costs incurred in developing a software program should be capitalized in accordance with Statement of Position (SOP) 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use, whereas costs incurred in the planning stage, such as researching the potential and different avenues that may be taken to develop a site, must be expensed as incurred. The development of the Web site, such as purchasing or internally developing software, acquiring the server, acquiring or internally developing integration software, and registering or purchasing the domain name, should be capitalized. Relating this to a Web site means capitalizing costs of development of the Web site up to the point of use (this would be the same conceptual point when placing fixed assets into service). As with many fixed assets, Web sites need accessories, the bells and whistles, (in computerese, graphics). Accordingly, the initial programming costs for these items should be capitalized. (The task force has deferred till a later date the treatment of costs incurred in content or populating databases. Practitioners should use their judgment to determine whether these costs will provide future benefits and need to be capitalized.)

In addition, costs incurred after this point has been reached (that is, the operating phase) that significantly enhance Web site functionality should be capitalized. Again, this is the same concept as if you materially altered the amount of production or estimated useful life of fixed assets. In essence, those costs incurred for such activities as training, updating, backing up, maintenance, and analyzing should be expensed as incurred. One item of note: The costs of registering the Web site with the various search engines are advertising costs and should generally be expensed as incurred in accordance with SOP 93-7, Reporting on Advertising Costs. (Contracts with the search engine companies need to be examined because generally these contracts are for presentation of a named amount of impressions, and when the contract expires, more likely than not there will exist a credit due the client for underdelivery of impressions.) The additional programming costs incurred once the site is launched must be examined to determine whether these costs are changes (that is, minor programming costs similar to repair and maintenance), or enhancements according to SOP 98-1, paragraph 24. If the costs incurred are changes to the programming, they must be expensed in the period incurred.

Going-concern issues
Web site-based companies and companies with an established presence on the Internet have an advantage that throws previous assumptions out the window—mainly, loss trends and negative net worth usually gave rise to the explanatory paragraph regarding going-concern or, at a minimum, full valuation allowances on deferred tax assets. The going-concern issue, in most instances, is readily placated by shareholder agreements to commit extra funds, guarantees by major customers and vendors, or acquisition agreements. These items are usually present in a viable Web site. However, due to loss trends a valuation allowance should be considered and evaluated on yearly basis.

Security of Web-based transactions
The concerns for Web consumers are—
- Are we dealing with a real company?
- Will transactions be entered, filled, and billed as agreed?
- Is customer information private?
- Is the transaction process secure?

To help clients and consumers feel confident with the security of the Web site, practitioners need to become familiar with services that may help protect a client’s site

continued on page 8
PCPS Executive Committee has a new Chair

We offer gratitude and best wishes to Harold Monk as he steps down from his position as Chair of the PCPS Executive Committee. Under Monk’s direction, PCPS established several task forces that developed a new focus on international and firm succession planning issues. These initiatives will continue to pay future dividends for PCPS member firms and the accounting profession as a whole.

Bill Balhoff of Postlethwaite & Netterville, Baton Rouge, Louisiana, will succeed Monk as Chair of the PCPS Executive Committee beginning in October 2000. For the past three years, Balhoff has served as a member of the PCPS Executive Committee; he also has served on the PCPS Peer Review Committee and has been Chair of the PCPS Task Force on Adding Value to Peer Review.

PCPS MAP Committee salutes leadership change

Kudos to outgoing chair of the PCPS Management of an Accounting Practice (MAP) Committee, Gary Shamis, of Saltz, Shamis & Goldfarb Inc., Solon, Ohio. Shamis has guided the committee in the development of the popular MAP issues forums, as well as serving as a resource on consolidations and changes in the profession. Shamis also served as an AICPA speaker at public hearings concerning the proposed Securities and Exchange Commission’s ruling on auditor independence.

Congratulations to incoming MAP Committee Chair Neal Harte of Harte, Carucci & Driscoll, P.C., Woburn, Massachusetts. Harte most recently served as president of the Massachusetts Society of CPAs and has served on the PCPS Executive Committee and the PCPS MAP Committee.

MAP networks

The MAP Large Firm Network will meet Monday, October 30, in New York. Network members will hear AICPA updates and news on consolidations in the profession. Not a member? Learn how to join by visiting the PCPS Web site at www.aicpa.org/pcps or call (800)-CPA-Firm.

The MAP Midsize Firm Networks will meet Monday and Tuesday, November 13 and 14, in Atlanta. Both networks will participate in discussions on value pricing and investment advisory services before breaking into separate groups.

For more information on MAP networks and upcoming events, visit the PCPS Web site at www.aicpa.org/pcps or call (800) CPA-FIRM.

AICPA MAP 2000 Focus on New Services

Join us November 2-3 in Phoenix, Arizona, for the AICPA MAP 2000 Focus on New Services. Providing nontraditional services strengthens market presence and paves the way for increased profitability. At the conference, participants will acquire timely instruction to offer a broad range of high-quality services.

Learn about:

- Multidisciplinary practices—Discover how successful firms, including the Big Five, are providing nontraditional services to grow their businesses.
- Asset management—Learn the do’s and don’ts in providing money management services.
- Strategic planning services—Benefit from practical knowledge in providing and selling this vital service.
- E-business—Help your clients create or evaluate their electronic business strategies.
- Retiring rich in public accounting—Gain an understanding of lucrative opportunities in real estate transactions, investment funds, and Web-based companies.

Registration is $795 for PCPS members, a $200 discount. For more information on the conference, including prices and registration, as well as a downloadable copy of the brochure, visit www.aicpa.org/calendar/conf5/map2000.htm. Recommended CPE Credit: 16 hours.

PCPS top talent staffing survey

Does your firm have great talent? Are you concerned about retaining the best staff possible? Find out what makes talented professionals join companies and what makes them stay there.

PCPS will soon distribute a “top talent” survey to managing partners at PCPS member firms. One or two of each firm’s most valued employees, as selected by the managing partner, will complete the survey questionnaire, offering valuable insight to staff retention in this tough labor market.

Watch your inboxes! The survey will be distributed by e-mail to select managing partners of PCPS member firms. The questionnaire will be available online and in hard copy format. Please encourage your staff to participate in this essential survey.

If you do not receive a questionnaire by e-mail and you would like to participate in the survey, please call (800) CPA-FIRM.

LETTERS TO THE EDITOR

The Practicing CPA encourages its readers to write letters on practice management issues and on published articles. Please remember to include your name and your telephone and fax numbers. Send your letters by e-mail to pcpa@aicpa.org.
and transactions with customers; they also need to know how to perform attest engagements concerning security of transactions and privacy of information. Customers need to know that information they provide to companies does not go beyond the company. The same is true for the transaction itself: Customers want to be assured that credit card numbers and authorization procedures are protected from outside interference. The AICPA has developed a service called Webtrust™ that could be of assistance in helping practitioners provide assurance that a client’s Web site meets established principles and criteria for business-to-consumer e-commerce. The CPA WebTrust seal warrants that a company complies with all the WebTrust Principles and Criteria for e-commerce.

In the future, CPAs will be able to offer their clients a more tailored WebTrust product. Soon, a client will be able to select the WebTrust Principle(s) most relevant to its Web site business from a “cafeteria selection” of Principles and request that its CPA report only on these.

**New responsibilities**

With Web-based sales revenues expected to be in the hundreds of billions of dollars per year over the next several years, our job as practitioners is to become familiar with the processes of new technologies. Firms should have, or be in the process of developing in-house computer information technology (IT) and e-commerce departments. Those firms that have not yet developed or are unable to develop an in-house IT department due to cost restrictions should develop a working relationship with an IT firm or another CPA firm that specializes in IT or e-business consulting.

Our duties have expanded to encompass the area of management consulting, as well as the traditional roles of auditor and tax preparer. Our responsibilities lie in helping clients develop business philosophies that will take them into the new millennium and help the accounting industry become proactive participants.

—By Patrick Malloy, CPA, is with Schwartz & Co. LLP in Bellmore, New York. He can be contacted at (516) 409-5000 or pmalloy@optonline.net. Malloy is also an adjunct professor at Adelphi University and at Hofstra University. For more information on CPA WebTrust, contact Sheryl Martin, WebTrust, Team Leader, at (201) 938-3751 or smartin@aicpa.org.