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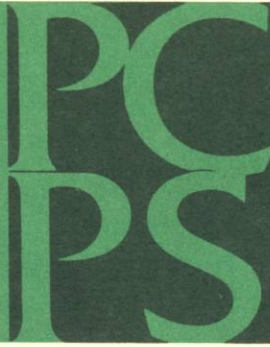
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APR 30 1984

Activities of the Private Companies Practice Section



April 1984

Vol. 5 No. 2

Reporter



Published by and for the Members of the Private Companies Practice Section of the AICPA Division for CPA Firms

Editor: John R. Mitchell

Peer Review Report

As this *Reporter* goes to press both sections' peer review committees are closing out the 1983 season, during which more than 350 firms were reviewed. They are also preparing for a very active 1984 season—over 800 reviews are anticipated.

The PCPS PRC continued its efforts to make reviews more relevant, effective and efficient. In recent months the committee—

- Established a consulting review program to assist firms in preparing for their initial peer reviews. A confidential one-day review will be conducted by an experienced reviewer. Half the fee will normally be applied to the cost of the firm's first peer review.
- Adopted guidelines for an off-site report review program for firms that issue compilation or review reports but perform no audits. These firms may elect to have a report review in place of a conventional peer review.
- Approved the 1984 edition of the PCPS *Peer Review Manual*, to be sent to members in late spring.

- Set the 1984 rates for reviewers whom the committee appoints at the same level as in 1983.

The accompanying cost summary includes only PCPS reviews that were conducted by committee-appointed review teams. It excludes hundreds of other reviews, such as those conducted by member firms or other authorized entities (on which cost information is not available), and reviews of firms that also belong to the SECPS. □

Member Services Committee Appointed

Responding to a major recommendation of the PCPS Structure Committee, the Executive Committee recently established the Member Services Committee and charged it to develop and administer a program of PCPS member services. The MSC will be a permanent committee, taking its place alongside the Peer Review and Technical Issues Committees.

Charles H. Bristol of Kalamazoo, MI chairs the MSC. Mr. Bristol is also a member of the Executive Committee. Other members are expected to include a past chairman and two other alumni of the Executive Committee and a Peer Review Committee member. □

Peer Reviews Conducted By PCPS Committee-Appointed Review Teams Cost Summary—1983 Peer Review Year

Firm Description	Number of Firms	Average Number of Professionals	Cost Per Review			Average Cost Per Review—1982
			Low	Average	High	
Sole Practitioner, No Professional Staff	2	1	\$ 625	\$ 862	\$ 1099	\$1204
2-5 Professionals						
1 Partner	5	3	1038	1678	2419	1729
2 or more Partners	11	4	1730	2186	2835	2129
6-10 Professionals	25	8	2121	3343	5856	2915
11-20 Professionals	32	15	2193	4665	7082	4886
Over 20 Professionals	7	30	4958	10384	17780	7933

Notes:

1. Cost includes reviewers' time charges, AICPA's 10% administrative fee, and reviewers' expenses.
2. These 1983 reviews include all those conducted by PCPS committee-appointed review teams for which the costs were fully processed at the time of compilation. Cost information is not available for firm-on-firm reviews or those administered by state societies or associations.
3. Hourly billing rates for reviews of firms with less than 20 professionals and no SEC clients are \$60 for team captains, \$50 for team members who are partners or proprietors, and \$40 for other team members. For firms with 20 or more professionals and all firms with SEC clients the rates are \$10 higher in each classification. For 1982 each rate was \$5 less.
4. PCPS member firms normally incur these costs once every three years.

Membership Profile

PCPS membership changed very little in the past year. The changes that did occur were in the same direction as in the two preceding years. Although the number of member firms declined slightly (six tenths of one percent), the number of CPAs and professionals in those firms increased as a result of an increase in the average size of member firms.

These trends may soon reverse themselves. As noted in your October *Reporter*, a major theme of the PCPS Structure Committee's recent report is the Section's need to broaden its impact on quality practice by attracting more sole practitioners and smaller CPA firms. With the Executive Committee's full approval the Peer Review Committee recently established two programs that could help do this—the new consulting review and report review programs. Other steps can be expected as the recently appointed Member Services Committee gets under way. □

PCPS Membership Statistics

	<u>March 1984</u>	<u>March 1983</u>
TOTALS		
Number of Member Firms	1,691	1,701
Number of CPAs in Member Firms	57,838	56,593
Number of Professionals in Member Firms	100,356	99,844
RATIOS		
Number of Partners		
1	14.2%	14.9%
2-5	61.0	60.1
6-10	17.8	18.4
11 or more	7.0	6.6
	<u>100.0%</u>	<u>100.0%</u>
Number of Professionals		
1	5.4%	5.7%
2-5	19.6	20.0
6-10	24.0	23.7
11-20	26.9	26.2
21-50	18.3	18.7
51 or more	5.8	5.7
	<u>100.0%</u>	<u>100.0%</u>
Number of Offices		
1	70.6%	71.1%
2-5	26.7	26.0
6 or more	2.7	2.9
	<u>100.0%</u>	<u>100.0%</u>
Number of SEC Clients		
None	81.5%	82.0%
1-4	15.6	15.4
5 or more	2.9	2.6
	<u>100.0%</u>	<u>100.0%</u>

Peer Review Leaflet Released

What Is Peer Review? is a new leaflet developed to help members of the Division for CPA Firms explain to their clients, their personnel and others the significance of their membership and the meaning of their peer reviews. Sample copies are being mailed to managing partners of all member firms. Supplies will be available at nominal cost from the AICPA Order Department, 212/575-6426.

The leaflet briefly describes peer review and the nine elements of quality control. It points out that the Division's "aim is to maintain and improve the quality of the accounting and auditing services performed by member firms."

"A peer review," it continues, "provides reasonable assurance that the accounting and auditing work done by the firm is quality work—work that can be relied upon . . . it means that a profession which plays an important role in the country's business and financial life is serious about self-regulation and actively pursues the goal of quality work by its members. The members . . . are willing to put their dedication to quality work to the challenge of a peer review every three years. Those who use financial statements and rely on a CPA's report reap the benefits of that dedication."

The new leaflet takes its place alongside other recently developed materials designed to help members convey the Division's message of quality and to emphasize the significance of their membership. In November the Division released two sample speeches, one intended primarily for business and professional groups, and a second more suitable for CPA audiences. In December, member firms were sent a peer review communications kit, consisting of a sample news release for local newspapers; a sample letter to clients, potential clients and other interested parties; and some suggestions about communicating the completion of a firm's peer review.

Single copies of any of these materials are available from the Private Companies Practice Section, 212/575-6446. □

FASB Takes Tax Accounting on the Road

In an effort to obtain the views of preparers, users and CPAs associated with small company financial statements, the Financial Accounting Standards Board will sponsor a series of meetings on accounting for income taxes in May, in Chicago, Dallas and San Francisco.

Last August the FASB issued a discussion memorandum on accounting for income taxes, which will be the basis of public hearings in New York on April 23-25. "We have not received many responses to the discussion memorandum or requests to participate in the public hearing from representatives of small companies or small CPA firms," said FASB Project Manager E. Raymond Simpson. "We are trying to obtain this group's views on

the project by holding meetings around the country, which may be easier for them to attend," he said.

Among the featured participants will be Technical Issues Committee Chairman James G. Castellano, at the meeting scheduled for the morning of May 15 near the Dallas-Fort Worth Airport; and former PCPS Executive Committee Chairman Robert A. Mellin, at the morning meeting on May 22, in downtown San Francisco. The first of the three meetings will be on the afternoon of May 3, near Chicago's O'Hare International Airport.

For details, and to register, contact Patricia Kelly, FASB, High Ridge Park, P.O. Box 3821, Stamford CT 06905. The phone number is 203/329-8401. □

New Chairman Elected



The PCPS Executive Committee has elected John T. Schiffman, of Smith, Batchelder & Rugg, New Hampshire, as its 1984-85 chairman. Mr. Schiffman, a member of the Committee since 1981, was one of the original members of the PCPS Peer Review Committee. He is a past president of the New Hampshire Society of CPAs.

Survival Strategy for Practitioners Serving Small Business

Editor's Note: This article consists of notes from an address by Stephen E. Burns, CA, to the September 1983 Annual General Meeting of the Canadian Institute of Chartered Accountants. Mr. Burns is a partner in Beallor, Beallor & Burns, of Toronto. The article is reprinted from *Accounting*, February 1984, published by The International Group of Accounting Firms, 3000 Biscayne Boulevard, Miami FL 33137. In your *Reporter's* opinion it reveals a surprising similarity in many of the issues facing practitioners on both sides of our northern border—along with a few sharp contrasts. (Note that Canada's "non-review" is very different from a compilation.)

Our topic today is to discuss survival strategy for practitioners serving small business. I will examine some of the issues facing the profession as a whole and then look at some of the issues facing segments of the profession.

First, let us consider the issue of standards overload.

Many practitioners feel that an overload situation exists today. Others would prefer the security of detailed rules to cover every conceivable situation.

The Task Force on Disclosure Differences, which I had the honour to chair, concluded that we do not have a significant overload problem today, but that care should be taken to ensure that such a situation does not develop.

This is not to say that we do not have problems in this area: Lease capitalization, deferred income taxes, related party transactions and consolidations and equity accounting are causing practitioners certain difficulties. But consider that in 1981 the FASB in the U.S. published 9 Statements of Financial Accounting Standards, 3 Interpretations, 6 Technical Bulletins, 16 Exposure Drafts, 1 Discussion Memorandum and 3 Invitations to Comment. The CICA, on the other hand, published 1 re-exposure draft that same year.

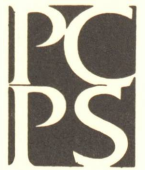
Larry Doane, in his inaugural address as president of the CICA, said that the purpose of the time and money that goes into research and standard setting is to improve accounting and reporting in the public interest. It was the view of the Task Force that the CICA, through its staff and committees, has done an effective job of serving that public interest.

Next, let us deal with unaudited financial statements.

You have heard how the bankers interviewed by the Task Force did not distinguish between review and non-review financial statements. This puts us into a Catch 22 situation:

Since a review will always be much more expensive to the client, how is he able to justify the higher cost if it makes no difference to his banker? In most cases, he cannot. Therefore, many small businessmen have learned or will learn to insist on an annual non-review with a Notice to Reader for tax purposes attached. If we accommodate him, we compromise our professional standards and downgrade the profession. If we refuse, chances are the client will find a new accountant — a CA or someone from another accounting body.

The Task Force concluded that the value of a review engagement would be enhanced by upgrading the Accountants' Comments to conform with review standards. We also agreed that there is a real need to educate the credit-



granting community particularly in the high professional standards required in a review. My personal opinion, and incidentally, one that was not shared by all the members of the Task Force, was that we must also allow an unrestricted use of non-review financial statements as is done in the United States. Many small clients just starting out in business require our advice but feel they cannot afford the cost of a review statement. If we do not serve them for this reason, then I feel we are not acting in the public interest. Furthermore, in many cases, annual financial statements are perceived by bankers as being of only limited interest, such as with professional practices and the many cases where the bank has personal guarantees.

In the changing environment, we must learn to expand our client services. We must become more consumer-oriented. The emphasis should be on how we can help our client. We must be responsive to his (or her) needs. In the not-so-distant past, we wrote up the small client's books, posted the general ledger, took off a trial balance, informed the client as to how much money he made or lost, sent out a bill, hopefully got paid and waited for the next year. Today, the client that relies on his accountant to tell him how he did three to six months after his year-end probably should not be in business — his own internal systems and personnel should be providing him with this information. I see the role of the practitioner serving owner-managed businesses as sort of a part-time Vice President of Finance encompassing not only the traditional areas of accounting, auditing and tax, but also the following additional functions:

- a business consultant for important business decisions
- a sounding-board for management's ideas
- a developer of forecasting techniques
- an evaluator and selector of computer hardware and software
- an initiator of new ideas, particularly in the systems and finance areas
- a procurer of financing from bankers, governments and other sources of capital
- a liaison with lawyers and other professional advisers
- a negotiator for all sorts of varied matters
- a developer of personnel benefit and incentive plans
- an accessor of sources of important business information
- a trouble-shooter for all the things that can go wrong
- a peace-maker for shareholder or partnership disputes.

The shift in emphasis is required from the past to the future.

Now let us turn our attention to survival issues facing segments of our profession.

A FACT

Of the 10,500 CA's in public practice in 1974, 12% were sole practitioners, 37% were partners or employees of the ten largest firms and 51% were partners or employees of local and regional firms.

By 1983, the number of practitioners had grown to 16,700: sole practitioners represented 13%, 1% higher than 1974; national firms represented 43%, 6% higher than 1974 and local and regional firms represented 44%, a decline of 7% from 1974.

During the same period, I estimate the growth in the number of small businesses to approximate the growth in practitioners.

The facts speak for themselves: the ten national firms have been able to increase their proportionate representation in the CA population at the expense of the local and regional firms.

How did this dramatic change happen?

The servicing of small and medium-sized business has traditionally been the domain of the local and regional firms, while national firms used to be associated with "big business." However, in the last decade the national firms have realized that future growth will come from the small business sector. After all, most big businesses presently retain a national firm as auditors. The situation is analogous with giant IBM, once having dominated the large mainframe computer market, now focusing efforts on the small-business-oriented personal computer. So the national firms developed marketing techniques designed to attract the small businessman. For example, the name recognition factor is an important element in new client referrals, and the nationals have recently been able to capitalize by initiating advertising campaigns. In addition to the internally-generated growth of the small business sector, much of the growth of the national firms has been accomplished through mergers with local and regional firms. Hardly a week passes without some announcement of such a merger. Many pressures to merge, both external and internal, are brought to bear on the local and regional firms, including:

1) Lack of Planning for Succession of the Firm.

Often, the founding partners are dynamic, entrepreneurial types who perceive late in their careers that their junior partners, for a variety of reasons, will not be able to fund their retirement. A merger can often provide an orderly retirement.

2) Inability To Attract Exceptional Personnel.

A common perception is that the national firms get the "pick of the crop" at on-campus recruitment. Merging will enable the practitioner to plug into an existing, highly-trained personnel pool to service client needs.

3) Fear of Competition.

The "how can we compete" syndrome breeds a fear of losing the larger clients with financially disastrous consequences to the firm. The perception is that clients want one firm to perform all accounting-related services. Thus, if the firm is lacking certain key specialties or geographical coverage, it is better to merge before the client decides to leave.

4) Other Factors.

Factors such as the difficulty in keeping up with standards, extremely heavy workloads, and problems in attracting new clients add to the merger pressures.

From the national firms' point of view, mergers can provide an excellent opportunity to expand geographical coverage and acquire qualified professionals experienced in serving the small business sector.

In summary, both the marketing skills of the national firms and the benefits of the merger route for both parties have contributed to the growth of the nationals in the small business area and the concurrent decline of the local and regional firms.

Although the shift in the CA population is dramatic, it is not necessarily a good or bad development. What is

important is that the public interest be served. I think this is best accomplished when all sectors of the profession are able to provide a high level of client service at a reasonable cost.

Let me now outline some strategies:

First, Sole Practitioners:

In the light of technological changes, tax complexities and all the skills and knowledge that a modern CA must bring to his practice, I don't understand how you have been able to increase or even maintain your proportionate representation.

All I can say is I wish you continued success.

Next, the local and regional firms:

Personnel

A firm is only as good as its people. Attracting, training and retaining qualified personnel is probably the most severe organizational problem facing most firms.

You must recruit on campus in order to have a chance at acquiring the best people. Concentrate on one or two schools. Introduce yourself to the accounting professors and try to enlist their support. Attend discussion groups on-campus relating to accounting as a career. Develop a firm recruiting brochure. Remember that many excellent students are not interested in joining national firms. Get your message across to these people.

A certain critical mass must be attained to support specialties. It is essential to develop specialists, particularly in computers, tax and quality control. If these are missing, hire from outside the firm or sub-contract the necessary talents.

Join an association of accounting firms to gain geographical coverage to service clients, a communicative network, a method of spreading costs for training programs and manuals and access to industry specialists.

Develop methods of ensuring succession of the firm: a clear partnership philosophy, perhaps currently funding a retirement plan for partners, an organizational structure appropriate for your firm, formal staff evaluations after each significant job, spending more time on management in the planning area.

Marketing

In the marketing area, do not be intimidated by the "bigness syndrome". Be positive — if you were the client, who would you choose as an accountant? Probably someone like yourself. Remember, it is the individual performing the work, not the organizational structure, that leads to a satisfied client. Develop a mix of services that give you a unique competitive advantage. Your most important quality, the personal service attribute, involves an intimate knowledge of operations, personnel and history, staff members who repeat and a "we care more" attitude. In these difficult times, costs are an important factor and your streamlining of review levels and lower general overhead should make you cost-competitive. Learn how to sell yourself and your firm.

Be Innovative

Let me give you a few examples:

If you don't have a computer, buy a micro, if for no other reason than to get one of the "spreadsheet" programs — they will greatly assist in income statement and cash flow projections as well as answer many "what if" questions.

For small businesses, consider doing the statement of changes in financial position on a cash rather than working capital basis. I have found it is usually more meaningful and can be easily compared to past and future cash flow projections.

Although the preparation of a set of financial statements is becoming more and more a science, it will always remain, at least partially, an art. Use your creativity to transmit financial information in the most appropriate manner.

Use your professional judgment to solve reporting problems.

Finally, the national firms:

Obviously, I have a bias in favour of the local and regional firms, but in the interests of public service, I feel compelled to pass on observations learned mostly from former clients and staff of the nationals. Hopefully, some of the ideas may assist you in serving the small business community.

Although not true of all national firms, nor certainly applicable to all of your offices, I know that some of you look at your small business division in terms of it producing \$500,000 audit clients. Consequently, there is often a lack of motivation in serving the client that will never reach that level. I think this attitude is wrong! Your small business division, if properly handled, can provide an immensely satisfying career for those partners and professional staff willing to devote themselves to this area. After all, it is the small business that often desperately needs your advice and skills. The large audit client has the resources to satisfy its needs internally.

Organization of the division is crucial. An optimum size can be determined, neither too small to support specialties nor too large to manage efficiently. As the division becomes too large, the configuration can be repeated in satellite offices. Review levels and audit programs must be streamlined in order to be cost-competitive. Supervision policies must be structured differently since non-productive time will quickly erode profits. Partners must learn to be accessible, even to the smallest client. They must make the client feel that he is just as important as the largest audit client.

Personnel have to be developed into professionals quite different than those in the large audit division. They have to be trained in entrepreneurial skills so that they are competent to give good advice. They have to learn to make business decisions — small clients want answers, not alternatives. Auditors that have learned materiality must also learn significance — an immaterial item, for example, a misclassification, may distort year to year comparisons. The "up or out" philosophy commonly associated with a large audit practice does not work here. Clients want continuity of personnel, so try to repeat staff at progressively higher levels.

In conclusion, the changing environment is changing the way we practice our profession. New skills have to be learned. Old habits have to be forgotten.

The last few years have seen a staggering amount of small business failures. It is generally conceded that the most significant factor in these failures is poor financial planning. Here is our challenge. By becoming more future-oriented, the CA, whether a sole practitioner or a member of a local, regional or national firm, can use his knowledge, skills and experience to assist the small business in meeting its challenges. □

PCPS Reporter

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