1980

Report of the Special Committee on Small and Medium Sized Firms

American Institute of Certified Public Accountants. Special Committee on Small and Medium Sized Firms

REPORT OF THE SPECIAL COMMITTEE ON SMALL AND MEDIUM SIZED FIRMS

AICPA American Institute of Certified Public Accountants

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October 1980

AICPA American Institute of Certified Public Accountants
1211 Avenue of the Americas, New York, N.Y. 10036

Special Committee on Small and Medium Sized Firms

Objective

To study the future viability and prospects of smaller and medium sized accounting firms which constitute the majority of practice units of the Institute and to develop programs to assure their ability to retain clients of significant size and standing in the financial community in competition with large national and international firms.

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Appointment of the Special Committee

The development of the public accounting profession has in many respects followed the growth characteristics of the business community which it serves. There are large, international accounting firms because there are large international enterprises. There are small, local accounting firms because there are small, local enterprises. Between the largest and the smallest companies, there are enterprises which can be well served by local, regional, national or international firms.

There is a continuing process in which businesses are formed and either prosper or founder. Some grow, and may eventually merge, sell out, or go public. The same process exists with respect to accounting firms. New firms are formed; some of them grow and they may eventually sell out or merge. Others may also grow and expand but choose to maintain their status as local, regional or smaller national firms. The existence of firms of different sizes creates a competitive environment which affects firms of all sizes.

The elimination of prohibitions against direct uninvited solicitation, encroachment, and advertising has intensified competition in an already competitive environment. There is concern that the relaxation of these rules has given the larger accounting firms a disproportionate advantage in the marketplace as a result of their substantial human and financial resources. There is concern that smaller firms may be replaced simply because they are less well known, even though the smaller firms may well be providing as high or higher quality services. A further cause of apprehension and concern has been the merger of smaller national accounting firms into larger firms, causing a higher concentration of publicly held clients and a further increase in the resources of an ever smaller number of very large firms.

These considerations were among the factors leading to the adoption of a resolution at the AICPA's annual meeting of October 23, 1978, calling for a special committee of members from small and medium sized firms.

Charge to the Committee

The stated objective of the AICPA special committee on small and medium sized firms is to

> study the future viability and prospects of smaller and medium sized accounting firms, which constitute the majority of practice units of the Institute, and to develop programs to assure their ability to retain clients of significant size and standing in the financial community in competition with large national and international firms.

The Special Committee was directed to include in its study the effects of certain discriminatory practices by banks, underwriters, investment bankers, audit committees, and other users of financial statements who select or influence the appointment of independent auditors.

Viability and Prospects

Problem

Concerns have been expressed about the viability and prospects of small and medium sized firms.

Conclusion

Practice in small and medium sized firms has been found to be professionally and economically rewarding to an ever increasing number of CPAs. Prospects appear bright.

The Committee attempted to assess the effects of economic realities of the free enterprise system on the accounting profession. Operating in such a system, it is inevitable that firms will employ every resource available to them and that some firms will be more successful than others. It is also inevitable that some firms will cease to exist for a variety of reasons. There will be mergers, some of which will be carried out as a part of planned expansion and some of which will be the result of a firm's inability to continue on its course. In this context, the Committee believes that recent firm mergers and dissolutions of some long-established accounting firms are the result of this evolutionary process.

In nearly two years of study of the viability and prospects of small and medium sized firms, the Committee found little or no evidence to suggest that well-managed firms have not been, are not or will not in the future, be viable, or that their prospects are likely to be anything but good. To the contrary, the weight of the data gathered by the Committee is that well-managed firms are generally growing and proliferating and that the principals of those firms are prospering. Thus, the Committee believes that small and medium sized practice units are viable and that their prospects continue to be promising.

In spite of examples submitted to us of the loss of clients as a result of matters such as pressure by underwriters and bankers and direct solicitation, our faith in the vitality of small and medium sized accounting firms has been strengthened. We find evidence that firms are facing up to the realities of a modern, competitive environment. Although there may be regret that the traditional concepts of professionalism are being eroded, there is determination on the part of many practitioners to maintain a high degree of professionalism and at the same time adapt to a changing environment.

The number of AICPA members practicing in small and medium sized firms has grown at a faster pace than the number practicing in the largest firms. This growth could not have occurred if practice in these firms were unrewarding. All indications are that more and more CPAs are finding practice in small and medium sized firms to be rewarding both professionally and economically.

AICPA Membership in Public Practice by Firm Size

(rounded to nearest 1,000)

Number of Members In Firm	*1969*	*1974*	*1-31-80*	*Increase – 1-31-80 over 1969*	
				Number	*Percent*
1 only	9,000	11,000	19,000	10,000	111
2-9	15,000	19,000	27,000	12,000	80
10-49	3,000	5,000	10,000	7,000	233
50-100	1,000	1,000	1,000	none	0
101-or more	15,000	24,000	27,000	12,000	80
Totals	43,000	60,000	84,000	41,000	95

The fact that this committee's efforts were directed primarily at the problems of small and medium sized firms should not be construed to mean that we were unaware of the advantages enjoyed by these firms. Those who participated in Member Forums which we sponsored, stressed advantages such as the ability to provide personal services, the benefits of intimate knowledge of clients' business affairs, economic rewards and the pleasure and personal satisfactions which are derived from working in a less formal structure.

Committee Procedures

During its existence, the Committee met twelve times, sponsored 106 member forums in forty states, held five public hearings in various parts of the country and solicited comments and suggestions from many sources to obtain as much information as possible about the status and the concerns of certified public accountants who practice in small and medium sized accounting firms. (See Appendix D) Committee members were impressed by the sincerity of those who responded to our requests for information and ideas. The viewpoints were as interesting as they were varied. Many respondents reported problems and stated frankly that they did not know what the solutions might be. Even though these respondents did not suggest solutions, they did help us to define the problems and direct our attention to the areas of most concern. Other practitioners stated the problems and offered solutions. Their suggestions were particularly appreciated, even though it is obvious the Committee cannot recommend the adoption of all suggested solutions.

It is interesting to note that there were instances in which CPAs with similar practices and backgrounds offered solutions which were diametrically opposed. Clearly, it is unrealistic to expect that there is, or will be, a common point of view on any particular issue. We believe this diversity of opinion exists among those CPAs who practice in large firms, those who practice in medium sized firms, and those who practice in small firms.

Initially, the Committee acknowledged that the diversity of the profession is reflected in the membership of the American Institute of Certified Public Accountants. Among the 161,000 members at July 31, 1980, 17,400 are sole practitioners, 70,000 are from firms of two or more and another 73,600 are outside of public accounting in business, government or teaching.

A question which must be answered is whether or not a national organization with such inherent diversity can examine issues, encourage discussion and reach conclusions which will be responsive to the membership at large.

In analyzing more than thirty distinct problem areas, the Committee became increasingly aware that solutions could not be broadly applicable, nor implementation even practical without active involvement by the national professional organization. Therefore, the Committee began by assessing the capacities of AICPA and state CPA societies to provide a forum for airing and resolving controversy.

We made a conscientious effort to be fair and objective in our analysis of AICPA as the national professional organization and in our analysis of the comments of those who are critical of the Institute. We recognize the criticism may be based either on fact or on perceptions, but that, in either case, it needs to be addressed. Our objective was neither to praise nor to criticize the Institute, but to find ways in which the organization and its members can be brought into closer harmony.

Management

No amount of effort on the part of a professional organization can assure the success of a CPA firm unless that firm is willing to provide itself with good management. Good management is one of the essential factors in providing quality service on which a successful accounting practice must be based. The programs of AICPA and state CPA societies can help, but the destiny of each firm will be determined by its ability to compete and to adapt to the times.

Members' Role in AICPA

The Committee sought to identify those characteristics that permit an organization to lead its members toward constructive solutions offering broad benefits. Listening carefully to practitioners who assembled at public hearings in five cities in November 1979, committee members were impressed by their interest and concern. Members, especially local practitioners, complained that opportunities to speak out were limited, that their views were not reaching higher professional councils, and that decisions were being made without adequate input from the more than 26,000 smaller practice units.

The AICPA has long been conscious of the problems of representing the diverse interests of its membership. Much has been done to assure that those interests are taken into consideration. (See Appendix C.) However, the membership is not fully aware of these efforts and more can be done to assure the members, particularly those who practice in small or medium sized firms, that the AICPA is continuing to do so.

Special Studies on Small Firms' Problems

Although the potential for conflict between large and small firms has always been present, and there has been a growing awareness that small firms were practicing in a climate they have come to regard as increasingly hostile, little has been done to help alleviate their problems until recently. The committee has identified the major attempts to address the problems of the profession which may affect small firms differently from larger firms.

1. Committee on Specialization – This study group examined the impact of certifying specialities. It found that small firms generally opposed this proposal, and the proposal was dropped.

2. Committee on Displacement of CPA Firms – In 1974 this group identified the dimensions of the problem, but found little that could be done to alter the circumstances in a competitive profession.

3. Committee on Generally Accepted Accounting Principles for Small and Closely Held Firms – This committee studied the problem of the use of GAAP by small and closely held businesses and recommended that distinctions be made in disclosure requirements under GAAP and that measurements under GAAP should be the same regardless of the size and structure of the company.

4. Advisory Groups – The AICPA formed three distinct groups representing large, medium sized and small firms, each with access to the Institute's Board of Directors to act as advisory agents representing their assigned constituencies. Ultimately, two of the groups were succeeded by the AICPA Division for Firms, with its two sections (SEC Practice and Private Companies Practice).

5. The Arnett and Danos Study – This 1979 study concluded that the profession needs to take a stronger stand against expanding government regulations. It chided the profession for not being more firm in opposing government regulations that offer few benefits to users.

6. Special Committee to Study Proposals to Restructure the Profession – This study concluded that the structure of the profession recognize that accounting is practiced largely by firms and that within the AICPA structure provision be made for the affiliation of firms. The result contributed to the establishment of the Division for Firms.

7. Associations of Firms – These have been organized across the country to assist firms with their continuing education, management training, and other aspects of managing an accounting practice.

Problem

CPAs serve or work with clients ranging from huge multi-national corporations to small, owner-managed businesses. Can one national organization adequately serve CPAs with such diverse interests?

Conclusion

AICPA is, and should continue to be, the national professional organization of all certified public accountants. Additional steps can be taken to provide further assurances of appropriate attention to the needs of diverse members.

Other activities are listed in Appendix C.

A strong, unified, national organization is essential for the good of the profession. Its role must include (1) setting technical standards and guidelines for practitioners, (2) ensuring members' compliance with those rules, (3) acting as an information source to keep the public informed about the profession, (4) serving as an advocate and spokesman for the profession, and (5) providing a forum for members to air diverse opinions on controversial issues affecting the profession.

The national organization must also serve as a source for professional education programs, assisting members to improve technically, professionally, and economically, and it must also assist CPAs to make a contribution to society.

Strong State CPA Societies Needed

At the same time, the committee recognizes that an effective national organization must be bolstered by strong state CPA societies. These localized organizations are necessarily closer to the members and are the source of productive member review of both technical and nontechnical issues. As agencies for ethics enforcement and providers of continuing professional education, their functions are securely established. State societies provide an essential link between AICPA and its membership, and play a key role in the communications network of the profession. Together, the AICPA and the fifty-four state and territorial societies support the profession's progress.

To Make AICPA Even More Responsive

Problem

AICPA members have felt that the interests of smaller firms are not always considered.

Recommendation

A high level AICPA staff person should be designated as the individual to contact whenever members need special assistance. This individual would aid members by referring their problems, inquiries or suggestions to the proper person or department at the Institute, and assuring that appropriate action is taken.

In its recommendations, which are developed in this report, the Committee offers a number of suggestions to make AICPA even more responsive to membership needs, especially those of the local practitioner.

These recommendations are designed to

- Encourage broader participation in AICPA activities.
- Simplify methods by which members comment on proposals for new technical standards or guidelines.
- Help small and medium sized firms to compete in today's marketplace.
- Assure high quality work by all practice units by both offering aid and imposing discipline.
- Find new ways to supplement the limited resources of smaller firms in public information programs.

In addition, to ensure that the interests of small or medium sized firms and the privately owned smaller businesses they serve are properly considered, the Committee suggests that a high-level AICPA staff person be designated as the individual to be contacted whenever members need some special assistance. This individual should be of particular benefit to small and medium sized firms by ensuring that their interests are considered and that their problem, inquiry or suggestion is referred to the proper person or department at the Institute and that appropriate action is taken.

If the AICPA is to be more effective, its members must assume their share of the responsibility. Our study indicates that many members are unaware of services available through the Institute. We found that members were suggesting to our Committee that the Institute undertake to provide services which are already available. This indicates a deficiency in communication. The Institute can improve its methods of communicating with members, but it cannot overcome the deficiency unless the members themselves are receptive and make an effort to be informed about professional affairs.

Standard Setting

The Committee considered the impact of regulation — both self-imposed and external — from the point of view of its effect on both competition and the growth potential of smaller firms. We considered how regulations, some of which primarily serve the public securities markets, affect smaller, privately held companies and the CPA firms representing them.

The profession assumes as a fundamental precept that standards for accounting, auditing and ethics should be set by the private sector. There is general agreement on this among practitioners, business leaders, and even government regulators; the Securities and Exchange Commission monitors professional standards, but prefers to leave their development to the profession.

Although acknowledging that rules give form and substance to the profession, practitioners are wary about the proliferation of rules. They insist that rules should meet some reasonable criteria before being imposed on the business community. It seems to the Committee that rules should be judged on their relevance, on their impact on the reliability of financial data, and on their cost effectiveness. Unless the cost is justified by benefits, a proposed rule should not be adopted.

Numerous financial reporting requirements are designed to meet the needs of the public securities markets. Because certain information is useful, even essential, to those who evaluate publicly traded securities does not necessarily mean that the same information is useful (or economically justified) for privately held companies. The profession should be responsive to the needs of the public market without imposing unreasonable burdens on private companies.

This issue has come up in various studies. One significant proposal resulting from a study produced by the AICPA Committee on Generally Accepted Accounting Principles for Smaller and/or Closely Held Businesses in August, 1976 was as follows:

> Although the same measurement principles should be applied to (general purpose) financial statements, because the measurement process is independent of other considerations, there should be some flexibility as to which disclosures are required. Data that is peripheral, and needed only for further analysis should not be required. The extent of detail necessary for any

particular disclosure may vary with the user. This group recommended that the Financial Accounting Standards Board (FASB) develop criteria to differentiate disclosures that should be required by GAAP (applicable to all financial statements) from disclosures which only provide additional or analytical data.

The Financial Accounting Standards Board has taken steps which exempt nonpublic entities from the requirements of reporting earnings per share and segment information. It also exempts smaller companies from inflation accounting requirements. FASB also has under consideration further distinctions in disclosure requirements. Nonetheless, the pace of progress since the 1976 AICPA Committee report was issued has been disappointing.

Member forums sponsored by this Committee in 1979 established that practitioners commonly believe some technical pronouncements to be geared to the larger public companies and that they are unnecessary and burdensome to smaller companies and their CPAs. At public hearings held by this Committee, some participants stressed that the FASB should set standards only for SEC companies; others said separate standards are needed for privately held business; and still others suggested that representatives of small CPA firms should screen proposed standards to assess the impact on smaller firms.

It became even more evident from the member forums and the public hearings that the environment in which smaller, privately held businesses operate is different from that of larger publicly held companies. Smaller businesses generally engage in less complex transactions, and are frequently owner-managed. Further, the needs of users of their financial statements — both owners and lenders — are different because of their more intimate knowledge of the business.

Problem

Financial accounting standards are, in many instances, designed to meet the needs of the public securities market. The cost of compliance with such standards exceeds the benefits to smaller companies.

Recommendation

The committee endorses the concept being studied by the FASB to distinguish between supplemental disclosures which might be required of selected financial statement preparers using GAAP and disclosures which would be required in financial statements of all GAAP users.

Recommendations Concerning Accounting Standards

The FASB has undertaken a project that could lead to a distinction between financial disclosures required to be a part of the basic financial statements and those which would not necessarily be made in the basic financial statements. It is expected that the latter type would not be required of all companies complying with generally accepted accounting principles (GAAP). These disclosures might be required of all companies whose stock is publicly traded but might not be required of privately held companies. This would be a step in the right direction and would relieve some companies reporting under GAAP from burdensome disclosure requirements. We endorse this concept and urge the FASB to proceed along these lines and to make meaningful and practical delineations in determining what types of companies should be required to make such supplemental disclosures.

Even though the change in direction described would be useful, many practitioners contend it will not grant sufficient relief to the numerous small, private companies which do not rely extensively on unsecured outside credit and whose principal stockholders are frequently company managers. Financial information developed for such companies need not be measured using the extensive, complicated rules developed for public companies.

Measurement and Disclosures Requirements

Some respondents suggested that distinctions should be made in the measurement requirements of GAAP as well as in GAAP disclosure requirements. The Committee concluded that the measurement principles used by entities reporting under GAAP should be the same regardless of the size or character of the company. The use of the term *generally accepted accounting principles* should indicate that the reporting entity measures its income, expenses, assets, and liabilities using the same standards as other entities reporting under generally accepted accounting principles.

On the other hand, distinctions can be made, provided that it is made clear to the users of the financial statements that an entity is not reporting under GAAP. This can be accomplished by the use of a comprehensive basis of accounting which does not constitute GAAP, and by assurance that it is made clear to the users of the financial statements that the basis is not GAAP.

Problem

Even though the FASB may exempt some companies from supplemental disclosures, many CPAs feel that adherence to some of the measurement standards of GAAP is not useful nor economically justified in small, owner-managed companies.

Recommendation

AICPA should appoint a special committee to study alternate means of providing additional relief from accounting standards which are not cost effective for small businesses.

A Look at Accounting Methods

We recommend that the AICPA appoint a special committee to follow up on the work of the AICPA Committee on Generally Accepted Accounting Principles for Smaller and/or Closely Held Businesses and to study alternative means of providing further relief for small, closely held businesses from accounting standards which are not cost effective for these businesses. The Committee recognizes that companies currently can report using the cash basis, the modified cash basis or the income tax basis of accounting. However, these accounting methods frequently do not meet the needs of users. Also, we have noted a lack of uniform guidance on the use of these methods.

Along with any other form of relief, we recommend that the special committee study the possible further development of the comprehensive basis of accounting concept or perhaps another comprehensive basis of accounting. Such a basic accounting method should be capable of meeting the needs of owners, credit grantors, and other users of smaller companies' financial statements.

Problem

Small and medium sized firms have not fully participated in the standard setting process.

Recommendation

To encourage members to comment on exposure drafts, the FASB and ASB should include with all exposure drafts a concise summary of the effects of the proposed standard and a self-mailer response form.

Impact on Small Business

The Committee strongly supports the suggestion that any body establishing standards, for either accounting or auditing, should, as a regular, procedural matter, consider the impact of its proposal on small businesses. It should be its obligation to assess the appropriateness of changes in standards for small businesses. In the Committee's view, introducing this procedure as part of the standards setting process will avoid imposing costly, irrelevant rules for reporting financial data of small companies.

Summaries of New Standards

The Committee was made aware that practitioners often do not take advantage of opportunities to comment on exposure drafts of proposed standards, rulings or interpretations. To assure the Auditing Standards Board, the FASB, and other standard setting bodies that the views of more practitioners are available to them, the Committee recommends that exposure drafts include a concise summary of the effects of the proposed standard, similar to the explanation carried in press releases, and also a self-mailer response form.

In the Committee's opinion, encouraging members to comment either on the entire proposal or some part of it, and providing an easy method for transmitting practitioner comments, should expand member participation in the standard setting process.

Continuing Professional Education

Thirty-seven states now require up to forty hours of continuing professional education courses annually for retaining a state license to practice public accounting. Prospects are that other states will impose similar requirements.

Mandatory CPE has had a significant impact on the profession, resulting in substantial additions to the curriculum offered by AICPA, the state societies and other providers. These offerings are varied, generally well-constructed and useful in helping practitioners maintain their professional competence.

The Committee acknowledges the progress made by AICPA with its self-study programs and the new VideoFlex (taped) programs for home or group study. While impressed with recent progress, the Committee nevertheless urges the Institute to continue expanding its course offerings and to ensure the ready availability of CPE courses at the lowest possible cost.

CPAs are taking these courses in record numbers, but not entirely because of the requirements. The increased complexity of public practice demands they keep abreast of new developments. Practitioners have expressed concern about increasing CPE costs, which include the practitioner's time, travel, and tuition.

The Committee remains concerned about relieving practitioners who are hard pressed to find time to absorb the material issued by AICPA and FASB announcing and describing new standards, rulings and interpretations. The Committee is conscious of the difficulty many practitioners have in diverting time from client services to the task of keeping informed about professional developments. Consequently, the Committee urges that AICPA develop new materials that would furnish busy CPAs with timely condensations or digests describing the application of new pronouncements.

Problem

Smaller firms must invest a disproportionate amount of time in keeping up to date on current professional developments.

Recommendation

The AICPA should develop videotapes to report current developments in professional standards, which could be used for in-firm meetings that would qualify for CPE credit.

The Use of Videotapes

The Committee specifically recommends that AICPA and CPA firms make more effective use of modern technology through the use of expanded videotape programs. With that in mind, the Committee suggests that twenty-five-minute videotapes be produced by AICPA on a regular basis, explaining new standards, interpretations and rulings. Firms could use these twenty-five-minute teaching tapes, supplementing them with twenty-five minutes of discussion for staff meetings, which would qualify for an hour of CPE credit.

The Committee also recommends development of a course on efficient engagement planning and performance. The course would teach how to estimate hours, and how to prepare reasonable proposals. Additionally the course would show how to make maximum use of statistical sampling techniques and computer audit techniques, when appropriate. Its goal would be to help firms plan audit work efficiently so that they would be in a position to price their services competitively without impairing the quality of their audits.

Problem

Intensified competition requires that CPA firms operate as efficiently as possible.

Recommendation

AICPA should develop a CPE course on efficient engagement planning and performance to assist firms in providing high quality services at reasonable cost.

Involvement in AICPA Committees

Many respondents felt that local practitioners are not adequately represented on AICPA committees. Statistics on committee membership do indicate an under-representation in proportion to their numbers as a percentage of AICPA members in practice. We believe that members who practice in small and medium sized firms can be adequately represented without the imposition of a quota system. To assure adequate representation, the AICPA must be able to identify local practitioners who have appropriate experience and are willing and able to serve.

A realistic approach to committee service must take into account the comparatively small number of opportunities for new appointments to serve in any one year. Altogether, there are only one thousand five hundred AICPA committee assignments. A member would normally serve on a committee for three years, making an annual turnover of approximately one-third (five hundred) of the assignments. That number must be drawn from a membership that exceeds 161,000.

Recommendations for Committee assignments come from a number of sources. The AICPA maintains a data bank containing information about potential appointees. AICPA writes to state society presidents and executive directors to solicit names of potential appointees. It also writes to associations of CPA firms for the same purpose. In addition, state society officers, directors and committee chairmen are contacted annually and invited to submit biographical data to be included in the data bank. The managing partners of firms having fifty or more AICPA members are also contacted for their recommendations. Members are recommended by other members or volunteer for committee service, and these individuals are also sent biographical data sheets that they may return for inclusion in the data bank. Information from the data bank is gathered by the AICPA staff and submitted to the incoming chairman of the board, who appoints most committee members.

In making committee appointments, it is desirable to consider

Problem

Small and medium sized firms are under-represented on AICPA committees.

Recommendation

The entire AICPA membership should be reminded annually through an Institute publication of the timing of committee appointment process. This notification should include information on how to cause a member's name to be included in the data bank from which committee members are selected.

geographical representation, firm size, industry representation, government and education affiliation, and the background and experience of the individuals who are under consideration. Maintaining an appropriate balance after considering all these factors is a difficult task. Those who submit data and are not appointed to committees should understand that there are only a small number of openings and that failure to be appointed does not constitute a rejection of the individual or imply that he or she is not qualified.

We understand that a special committee is being formed to examine the committee selection process and to make recommendations for its improvement. Nevertheless, we believe the following recommendations should be considered now.

To improve the means of identifying qualified members for committee service, and to locate those willing to serve, we recommend that the CPA Letter or other AICPA newsletters and publications be used to remind members of the timing of the committee appointment process. This reminder should explain how to obtain a biographical data sheet for inclusion in the data bank. We further recommend that the request for names to be considered for committee assignments be sent out prior to the beginning of the busy season (they are now sent out in January).

Problem

The expense of attending committee meetings may be a deterrent to acceptance of committee appointments.

Recommendation

AICPA committee expense reimbursement policy should be revised to state simply that travel expenses incurred by members in connection with committee service are reimbursable.

Cost of Committee Service

The Committee concludes that the cost of attending committee meetings should not be a factor that prevents any member from serving on a committee. AICPA now reimburses committee members' expenses upon request, but many members are reluctant to request reimbursement because the policy statement refers to a financial burden. We therefore recommend that the AICPA policy on reimbursement of travel expenses incurred in committee service be revised to eliminate any implication of a stigma being attached to a request for reimbursement. The policy statement should state simply that travel expenses incurred by members in connection with committee service are reimbursable without mention of financial burden or similar criteria.

We considered the possibilities both of time reimbursement as well as a per diem reimbursement for time spent in committee meetings when that time exceeded a predetermined number of hours in a single year. The Committee concluded, however, there are benefits to be derived from committee service, and that members are willing and anxious to serve. For those reasons, we recommended no change be made in the current AICPA policy in regard to time reimbursement.

Problem

Small firms with limited library facilities may not have all AICPA publications on hand.

Recommendation

To improve access to AICPA services and publications, a toll-free number should be obtained for use in ordering materials and publications. Same day shipment should be available when requested.

Access to AICPA Services

AICPA membership services, useful to all members, are extremely important to medium sized or smaller firms, which may have less extensive libraries and research facilities. Because of this, it is important that AICPA publications be readily available. Toward that end, the Committee recommends that AICPA obtain and publicize a toll-free telephone number which members could use in ordering materials and publications. This service should include a plan to ensure prompt shipment and same day service when requested, even if that entailed a price differential. When a small firm is faced with an immediate need for publications not in its own library, this plan would ensure prompt availability.

The Committee was asked by practitioners to evaluate a proposal for establishing distribution centers across the country which would permit shipping from points closer to the destination. Although the membership is right to urge AICPA to take what steps it can to ensure prompt availability of materials, we believe that the manner and place of shipment is a matter to be considered by AICPA management, rather than by this Committee.

Each work day fifty or more practitioners call AICPA for information on the application of technical standards. Their questions and some thirty letters a month are answered by the AICPA Technical Information Service. Users generally are smaller CPA firms, who receive such benefits without charge. The Committee acknowledges that the service is valuable but feels, nevertheless, that AICPA should expand the service. We recommend that a toll-free number be provided for practitioners to reach either the AICPA Technical Information Service or the Library.

The Committee was made aware of the numerous services that help firms in their practice management. (See Appendix C) Some criticism has been lodged that not enough was being offered by AICPA, but the Committee found that members frequently were simply not aware of the available services. The solution to this may well be a more aggressive information program with AICPA communicating directly with firms.

The Committee found at least one practice development area in need of more attention: development of guidelines to help prospective clients evaluate competitive proposals. Expanding on the provisions of Management Advisory Services Guideline #2 *Documentation Guide for Administration of MAS Engagements,* these guidelines would include full descriptions of services to be rendered, including accounting, auditing, tax advice, and management advisory services. The guidelines should also require statements estimating hours to perform each of these services, the projected time of completion and some indication of the qualifications of the firm to render the services. The Committee considers it imperative that these guidelines, once promulgated, be widely publicized.

Solicitation

The AICPA Rules of Conduct state that "solicitation to obtain clients through false, misleading, and deceptive statements or acts is prohibited. . . ." An interpretation of this rule lists activities considered to be prohibited and includes among such activities advertising or other forms of solicitation that "contain any other representations that would be likely to cause a reasonable person to misunderstand or be

Problem

Firms frequently may not have adequate technical information in their libraries.

Recommendation

A toll-free number should be provided (and publicized) to facilitate members' calling AICPA's Technical Information Service and Library.

Problem

Clients may not be in a position to evaluate proposals for engagements.

Recommendation

Guidelines should be developed for proposals for engagements which give prospective clients a sound basis for making comparisons.

Problem

Solicitations of clients may contain misleading information or implications.

Recommendation

AICPA Professional Ethics Division should expand its interpretations of false, misleading or deceptive acts to include a list of misleading solicitation practices.

Problem

Now that advertising is no longer prohibited, smaller firms may find it difficult to determine whether or not they should advertise, and how to go about it if they decide to advertise.

Recommendation

AICPA should develop training courses to assist practitioners in answering the basic questions about advertising.

Problem

Some members feel they do not have an opportunity to express their views to the membership.

Recommendation

The Journal of Accountancy *and other publications should encourage and publish letters to the editor which express members' points of view and contribute to a better understanding of professional issues.*

Problem

Auditors are sometimes chosen on the basis of arbitrary factors such as size of their firm.

Recommendation

An information booklet should be published stressing that the selection of a CPA firm should be based not on size, but on the ability to provide service.

deceived." To discourage solicitation practices which are likely to be misleading, we recommend that the AICPA's Professional Ethics Division expand on this interpretation by listing practices which are considered to be misleading. Such practices might include submission of a fee estimate with the knowledge that the fee is likely to be substantially increased because of additional work which will be necessary to complete the engagement. The list might also include the submission of a fee estimated for one period with an implication that the fee would be comparable in a subsequent period in cases where the CPA has knowledge that the fee will be inadequate for subsequent periods.

Advertising—Public Relations

The Committee feels that smaller CPA firms may welcome help and advice concerning advertising, and we believe that the AICPA can provide at least two distinct services:

1. Training workshops and seminars to help practitioners answer such basic questions about advertising, as whether or not to advertise, how to advertise, where to start and what the message should be.

2. Materials that can be imprinted with a firm's name for distribution to the public. Leaflets and booklets would be useful supplements to the newsletters and other materials that the AICPA already makes available.

We urge more state societies to establish speakers' bureaus of local practitioners and assist in placing them before business groups, and to develop cooperative advertising programs in which the smaller firms may participate. Another useful service would be joint AICPA and state society sponsorship of meetings between members and representatives from federal agencies to call attention to the availability of government contracts and explain how to obtain them.

Letters to the Editor

So that members would have an additional opportunity to express themselves, and to foster a productive exchange of information there should be a "Letters to the Editor" department in AICPA and Society publications.

A Public Relations Program for the Firms

The Committee received a number of proposals and suggestions dealing with the general area of public information. Practitioners feel there is an insufficient understanding of the nature of services provided by CPA firms. They are particularly concerned that it is not understood that firms of all sizes offer a broad range of service and that quality control standards are applicable to all CPA firms.

The Committee has discussed elsewhere in this report its conviction that the selection of a CPA firm should be based on its ability to provide the needed services and not on such arbitrary factors as size. The Committee recommends moving ahead on the preparation of an information booklet for public and private companies that would offer general guidelines on selecting an auditor. The booklet should discuss factors companies should weigh when evaluating proposals for accounting and auditing engagements. This recommendation has already been made to the AICPA Board of Directors, and work on such a booklet has begun. We recommend this project be given high priority.

Many within the profession have suggested that the AICPA design and implement a national public relations program. It is the Committee's view that the current level of public relations activities conducted by AICPA on a national level and the coordinated local programs, carried out in collaboration with state societies, provides a highly visible informational program on behalf of the practitioner. Nevertheless, the Committee recommends that AICPA give consideration to an expanded program which would include publicizing the type of information included in the proposed booklet to bring about a more objective selection process. Effective dissemination of this type of information could help persuade underwriters, credit grantors, audit committees and others involved in the selection process that a firm capable of providing quality service should not be excluded from consideration simply because it is smaller or less well-known than another firm.

Problem

The public lacks understanding to make objective selection of a CPA firm.

Recommendation

A national public relations program should be designed and implemented to bring about a more objective process of selection of a CPA firm.

Role of the Private Companies Practice Section

Local practitioners say they are not able to exert much influence over the standard setting process. The problem is not that local firms are not asked to comment on proposals, since drafts are generally circulated to most practice units. They admit that when exposure drafts are received, practitioners frequently do not respond because of time constraints, or a feeling that the proposal may not concern them in their practice. Nevertheless, practitioners complain that rules are written with little regard for their impact on local firms. What local firms need, according to statements made to this Committee, is a vehicle to represent their interests.

The AICPA Division for Firms was established in 1977 in response to pressure for more effective self-regulation of CPA firms. That division consists of the Private Companies Practice Section and the SEC Practice Section. The Private Companies section has as a principal function making the views of local firms more generally known and expanding their impact on developments in the profession.

Influence on Technical Standards

The Private Companies Practice Section of the AICPA Division for Firms can be an effective voice for small and medium sized firms. The PCPS has established a technical issues committee with the assignment of reviewing and commenting on proposed professional standards, with particular emphasis on the effect on private companies and their CPAs. With respect to financial accounting

Problem

It is felt that the needs of small businesses and their CPAs are not adequately considered in the development of financial accounting standards.

Recommendation

The Private Companies Practice Section can become a more effective voice of smaller CPA firms and their clients. A procedure should be developed whereby PCPS positions on accounting standards could be required to be transmitted by AcSEC to FASB in circumstances under which a substantial majority of the PCPS Executive Committee requests it, even though AcSEC may have taken a different position.

PCPS also should encourage member firms to respond directly to the FASB on exposure drafts.

standards, the PCPS transmits its comments and recommendations to the AICPA Accounting Standards Executive Committee (AcSEC), which is, in turn, the AICPA spokesman on accounting standards. If AcSEC takes a position different from that recommended by the PCPS, there is no assurance that the PCPS position will be made known to the FASB.

AcSEC has been designated as the only AICPA body to comment on proposed FASB standards. Nonetheless, we recommend that procedures be established that would ensure that the FASB is made aware of the PCPS position on important issues, even when AcSEC may disagree. This can be accomplished by AcSEC transmitting to the FASB, as a part of its comments, the position of the PCPS if the PCPS Executive Committee requests it by a vote of two-thirds of its membership. The Committee also suggests that the PCPS encourage its member firms to submit their comments to FASB.

Smaller firms should have more influence in the standard setting mechanism. As their representative, PCPS lacks the authority to achieve optimum results. Therefore, the Committee recommends that steps be taken to strengthen PCPS so that the organization is better able to advocate the interests of small and medium sized firms and to promote the promulgation of accounting and auditing standards which are appropriate for privately held clients.

In the interests of improving PCPS's ability to serve its constituency and the profession at large, it is urged that firms not already holding a membership in the Section consider joining.

Peer Review

Problem

The cost of peer reviews is thought to be disproportionately high for smaller firms and peer reviews are thought by many to place too much emphasis on the structure of firms.

Recommendation

The AICPA Division for Firms should publicize the fact that peer reviewers expect firms to have quality control policies and procedures appropriate for their firms, and that policies necessitated by the size of larger firms will not be imposed on smaller firms.

Many practitioners feel that smaller firms incur a higher per capita cost when they participate in peer review programs. Steps were taken recently by the Private Companies Practice Section to develop an engagement-oriented peer review for firms with fewer than twenty professionals that emphasizes the work done rather than documentation of compliance with procedures. Both sections of the Division for Firms have an obligation to monitor peer review programs to ensure that the cost of compliance does not exceed the benefit.

Greater emphasis should be placed on the fact that adherence to the elements of quality control may be achieved in many different ways based on the size, characteristics and philosophies of firms. Firms should be made more aware that peer reviewers expect smaller firms to have appropriate quality control policies and procedures, but that there is no reason to fear that policies necessitated by the size of large firms will be imposed on smaller firms. With a better understanding of this concept, we believe that smaller firms will be less apprehensive about peer reviews.

The Bigness Syndrome

Smaller and medium sized firms are faced with a problem similar to one that has been faced by business and even governments, and that is the "bigness syndrome." Does bigger mean better? In the selection of a CPA firm, size is important only to the extent that it indicates sufficient staff to carry out the engagement.

One of the most serious problems that arose during the period of explosive growth in the new issues securities market during the late 1960s and early 1970s was displacement of CPA firms in public offerings. In 1969 AICPA President Ralph Kent stated—

> Too often, we are told, the underwriter insists on a change in auditors from the local firm to a national firm. Obviously, it is a distressing event for the local firm which experiences the loss of an expanding, and frequently prestigious, client. This distress is accentuated in those cases where the local CPA has contributed substantially to the growing prosperity of the client by his management counsel above and beyond the audit work...
>
> More often than not, the client is unwilling to place the retention of his local CPA on his list of must items and, unhappily, he too quickly accepts the seeming mandate of the underwriter.

A major effort was made by the AICPA and the New York State Society of CPAs to deal with the displacement problem. Committees met, and a number of underwriters agreed not to discriminate against smaller, competent firms solely to make an issue allegedly more marketable. Since that time the new issues market has greatly diminished and equity capital participation in emerging businesses has become less attractive to the public.

The profession, nevertheless, should continue to make the financial community more aware of the standards of the accounting profession, including quality control, which are applicable to all firms.

Discriminatory Clauses in Financing Agreements

The profession has not yet given sufficient consideration to discriminatory clauses in underwriting and loan agreements. The committee has been advised of examples of such agreements that required examinations of financial statements by "big eight" accounting firms or by "nationally recognized firms." We believe that the profession should vigorously oppose clauses that discriminate for or against any particular size or type of firm. Selection of an auditing firm should be based on the firm's ability to provide the required services, not on its size.

Failure to oppose such discriminatory agreements leads to a further concentration of auditing services in an increasingly smaller group of the largest firms. This is not in the public interest since companies and other entities should be offered a choice from among firms of various sizes and characteristics. The committee recommends that the AICPA Council pass a resolution stating that it is the policy of the AICPA to oppose clauses in agreements that discriminate either for or against any firm because of its size or type. This policy would not apply to government set-aside programs.

We further recommend that a mechanism be established within AICPA to receive examples of discriminatory clauses based on size or

Problem

Loan agreements and similar documents sometimes contain discriminatory clauses which require that financial statements be examined by firms of a particular size or type.

Recommendation

AICPA Council should pass a resolution stating that it is the policy of AICPA to oppose clauses in loan or other agreements which discriminate in favor of, or against, any particular group or type of accounting firm.

We further recommend that mechanisms should be established within the AICPA to receive examples of discriminatory clauses. The institution inserting that clause would be contacted and advised of the AICPA policy and asked to refrain from the use of such clauses.

type of firm submitted by members or others. The underwriter, bank or other organization that used the discriminatory clause would be contacted and advised of the AICPA policy in opposition to such discriminatory clauses. The reasons for the policy would be explained and the offending organization would be asked to refrain from the use of such clauses in the future.

Audit Committees

Problem

Audit committees have shown a tendency to disturb existing CPA-client relationships without sufficient cause and to further the concentration of audit engagements by selecting larger accounting firms.

Recommendation:

More publicity should be given to the fact that it is not one of the required duties of the audit committee to select the independent auditors. Audit committees merely **approve** ***the selection. When an audit committee actually makes the selection, it is put in the awkward position of evaluating the performance of its own selection.***

Audit committees have been encouraged by the AICPA, the Securities and Exchange Commission, stock exchanges, and others. Audit committees composed of outside (non-management) directors provide a means of assuring that the auditor can communicate directly with a company's board of directors without management interference. They operate to prevent management from censoring or withholding information and comments issued by the CPA firm and to shield CPA firms from management efforts to place undue pressure on auditors.

Audit committees occasionally have been inclined to select one CPA firm simply because it is more widely known than another, even though the less well-known firm may be quite competent to provide the client with all the services it needs. Sometimes, audit committees have disturbed long-standing CPA-client relationships without sufficient justification. A report of the Special AICPA Committee on Audit Committees issued in December 1978 listed the duties of audit committees, including the duty to "*approve* the selection of the independent auditor" (emphasis added). It is important to note that this does not require *selection* of the independent auditor. This is an important distinction that seems to receive insufficient recognition.

Another duty of the audit committee is to "review the arrangements and scope of the audit." This duty entails a determination of the adequacy of the scope of the audit. This, in conjunction with the duty to approve the selection of the independent auditor, means that the audit committee will be passing judgment on the auditing firm's ability to carry out the engagement satisfactorily. It is also customary for the audit committee to discuss the engagement with the auditors upon its completion to determine that the planned scope of the audit has been carried out satisfactorily. If the audit committee makes the actual selection of the auditor, it is placed in the awkward position of having to assess the performance of the auditor it had itself chosen.

Audit committees may be useful for larger public companies, but it should be recognized that they may not be justified in other companies.

AICPA's Removal of Ban on Direct Solicitation

Many AICPA members have reported a belief that the membership vote removing the ban on direct, uninvited solicitation was based on a misunderstanding. The direct uninvited solicitation ban was adopted in 1978, when members removed a rule prohibiting all advertising and solicitation. That rule was replaced by a prohibition against advertising or solicitation by false, misleading or deceptive means. Direct uninvited solicitation was also banned. Uninvited solicitation lends itself to extravagant claims being made which would be false, misleading or deceptive, under conditions that would be very difficult to police. Therefore, the ban on direct uninvited solicitation was an outright prohibition and not limited by the false, misleading or deceptive standard.

On advice of the Institute's outside legal counsel, the membership was presented in 1979 with a proposal to delete the ban on direct uninvited solicitation. In authorizing the mail ballot, Council voted to advise the members that it did not favor the deletion.

The same ballot contained a proposal to delete the rule against encroachment. The membership voted to delete the bans on direct, uninvited solicitation and on encroachment. Many members believe that consideration of both the encroachment and solicitation prohibitions in the same ballot caused the two to be regarded as one issue. They feel that the membership was not sufficiently informed that they could eliminate one prohibition while retaining the other. They feel that the direct uninvited solicitation ban might have been retained had the membership been provided with a more objective discussion of the subject and had the two issues not been voted in the same ballot.

The Committee has reviewed the material which accompanied the challenged ballot and believes that the matter was clearly and objectively presented and that it is not unusual for ballots to members to deal with several unconnected issues.

However, it is clear to the Committee that many members (some of whom may have voted for deletion of the direct, uninvited solicitation ban) would prefer that the ban were still a part of the Code of Professional Ethics. We, therefore, recommend that the board of directors engage outside counsel who has not previously advised the Institute on the impact of the antitrust laws on such a rule in the Institute's Code to review the matter. If that firm's advice confirms advice from the Institute's legal counsel previously given, it should be widely disseminated so that the membership will understand the Institute's legal position. If the advice differs, we recommend that consideration be given to reinstating the ban.

Problem

Many members have indicated that the elimination of the ban against uninvited direct solicitation of clients was based on a misunderstanding. They believe that such solicitation serves no public purpose and puts pressure on CPAs to subordinate a desire to adhere to high professional standards to their desire to obtain clientele.

Recommendation

To remove any doubt as to the intention of the membership with respect to this rule, the Board of Directors and Council should engage outside counsel to advise on the impact of anti-trust laws on such a rule.

Reliance on Other Auditors

In one instance, the professional standards themselves have led to cases of discrimination against a smaller firm by a larger principal auditing firm. Statement on Auditing Standards 1, section 543 describes the circumstances under which a principal auditor may rely on the work of other auditors. The section states when the principal auditor may disclose the reliance on other auditors.

In cases where a client wishes to retain different auditors for a segment of the enterprise, professional standards should encourage the principal auditor to rely on the work of the original firm, provided that firm meets special standards such as peer review. It is inconsistent to expect the public to rely on CPA firms when firms may be

Problem

Professional standards are applicable to all CPA firms. Steps such as peer reviews have been undertaken to assure adherence to quality control standards; however, Statement on Auditing Standards #1, section 543 seems to imply that one CPA firm need not rely on another.

Recommendation

SAS 1, section 543 should be reviewed by the Auditing Standards Board to provide a means by which the principal auditor would rely on the auditors of segments without referring to that reliance in their reports.

unwilling to do so themselves, particularly in view of the requirements of the Division for Firms. We recommend that the Auditing Standards Board review section 543 and that it devise a form of comfort letter or some other mechanism the auditor of a segment of an enterprise would submit to the principal auditor and on which the principal auditor would rely.

Transformation of a Profession

Following the Second World War, the accounting profession went through a transformation that paralleled the rapid expansion of the economy. During this era, the growth-by-merger movement took hold. Large CPA firms embarked on aggressive campaigns to become larger by absorbing local firms and by establishing operating offices in an ever-increasing number of cities. Coincident with these mergers, there was an expansion of scope of services. Giant firms began to attract employees from other disciplines. As client companies expanded, becoming multi-national, their auditors followed, organizing international partnerships and developing facilities to satisfy a broad spectrum of needs.

Wallace E. Olson, former president of the AICPA, has summarized the parallel development of two types of firms:

> Out of these developments grew the two-tiered profession that exists today, characterized by sharp differences in organizational and management structure and the general nature of clientele that is served. The large national firms adopted all the commercial traits that their size required. Their practices became more commercial in tone. Their chief executive officers became subject to pressures from the owner-partners to achieve annual increases in gross fees and net earnings. Aggressive tactics to sell more services and attract new clients became commonplace. If such activities did not violate the letter of the profession's behavioral rules of conduct, they certainly did damage to their spirit.
>
> The smaller firms were also becoming more aggressive, but it is probably fair to say that they were more restrained and more inclined to abide by the intent of the rules of conduct. Perhaps, this reflected the fact that their practices were still being conducted on a more personal basis and in the form of traditional professional partnerships.

Today's larger accounting firms evolved in the wake of the emerging national and multinational businesses whose needs for accounting and auditing services may require fully staffed offices at numerous sites. The small and medium sized firms serve thousands of companies subject to fewer regulations, whose needs are frequently less complex. Most of these companies are privately held.

It does not follow, however, that large firms are interested only in large clients, or that small firms are interested only in small clients. Competition has grown more intense. The number of business mergers and start-ups has decreased and larger firms now look to smaller companies for new clients.

As a result, many smaller CPA firms have come to recognize the necessity for practice development programs that are designed to increase their visibility and attract potential clients. Some smaller firms have felt they are driven to more active practice development to remain competitive.

The Committee sought to identify more precisely the concerns of small and medium sized firms. It began by asking for responses from these CPA firms. The responses revealed several problem areas such as the financial disadvantages of being smaller, the competition for professional personnel, limitation of services they might offer clients, the mystique of the international accounting firms and some alleged unfair practices they attribute to larger firms. As a further step, the Committee participated in Member Forum discussions, held under the auspices of state societies. These forums disclosed a number of practices carried out by larger firms in their practice development efforts that small firms insist put them at a competitive disadvantage.

Some of these practices were considered to be unfair as well as disadvantageous to smaller firms, but others including advertising, were realistically accepted as the "facts of life" in a modern, competitive environment, even though they might be disadvantageous.

The member forum survey identified promotional practices and asked: Do you believe the practice to be disadvantageous to small firms? and, Do you believe it to be unfair practice? More than half said that ten practices were disadvantageous to smaller firms. Leading the list was a tendency of bankers, credit grantors and attorneys to favor larger firms when referring clients to CPA firms. The practices identified by fifty percent or more of the respondents as disadvantageous and unfair were

- A tendency of bankers, credit grantors, attorneys, and audit committees to favor clients of larger CPA firms
- Offering services on initial engagements at lower than normal rates
- Soliciting clients of other CPA firms
- Accepting engagements from a client when called in by another CPA firm in a contractual arrangement to assist
- Charging low fees generally, not just for initial engagements.

The practices identified by fifty percent or more of the respondents as disadvantageous, but not unfair, were

- Presenting elaborate proposals to prospective clients
- Maintaining liaison with federal agencies to obtain government contracts
- Ethics enforcement which may have more severe effects on smaller firms
- Advertising
- Holding seminars for bankers and other professionals.

The Committee is aware that the Justice Department views low fees as a legitimate competitive practice, beneficial to consumers and proof the free enterprise system is functioning. On the other hand, in a speech delivered on April 23, 1980 before the Accounting Research

Center at Northwestern University, SEC Chairman Harold Williams said

> While I certainly endorse fee competition—I doubt that users can have confidence in accounting services based on below-cost fee commitments—particularly multi-year arrangements—and particularly where no provision is made for any increases to cover previously unanticipated problems. To a large extent, the resolution of these concerns depends on the commitment to independence and professionalism of the particular firm or office, and the partner in charge of the engagement—the most important individual in the process—and the discipline the firm brings to bear.

Concern over the effects of below cost fees has also been expressed in the Arnett and Danos Study and by The Commission on Auditors' Responsibilities. Because of these concerns, we recommend that the AICPA Professional Ethics Division study the potential effects of below cost fees on independence and consider the issuance of an interpretation of the independence rule covering this subject.

Problem

Concern has been expressed about the potential adverse effects of below cost fees on independence.

Recommendation

The AICPA Professional Ethics Division should study the effects of below cost fees on independence.

Practice Development and Quality

Practice development policies that are unfair and that also are likely to have an adverse effect on the quality of accounting and auditing services should be eliminated. If firms are to compete on a basis of quality, it is necessary to remove, to the extent possible, those factors that may lead to poor quality or that are likely to have an adverse effect on quality. It is in the public interest as well as in the interest of the profession to encourage a commitment to quality throughout the profession.

Commitment to Quality

The AICPA has established a Practice Review Committee to which financial statements are submitted by anyone who believes that a report shows possible evidence of substandard reporting practices. It is important to note that this is an educational rather than a disciplinary program. We recommend that a similar program be established so that practitioners, bankers, other credit grantors, stockholders, or the public at large can submit to AICPA any information that they believe raises a question about the ability of a firm to perform a proper audit. This would include financial statements, such as those that are currently being submitted to the practice review committee. It would also include information that appears to indicate that a firm was not in a position to perform the service properly, such as the submission of a proposal that contained an estimated number of hours clearly inadequate for completing the engagement. It would include instances in which the observer concluded that the firm clearly did not have sufficient personnel or expertise, or access to sufficient personnel or expertise, to carry out the engagement. It would include instances in which the proposed fee was so low that questions were raised about the adequacy of the number of hours budgeted for the engagement.

Problem

Intensifying competition may encourage some firms to accept engagements under circumstances which make it difficult for them to adhere to professional standards.

Recommendation

AICPA should develop a program for the submission of information which, on its surface, might indicate the inability of a firm to adhere to appropriate standards. This type of information might include instances where there are indications that insufficient hours were budgeted to complete the engagement properly, or a proposed fee was so low as to question the adequacy of the number of hours budgeted, or a firm did not have sufficient personnel or expertise, or access to sufficient personnel or expertise to carry out the engagement. Such information would be made available to peer reviewers so they could determine whether or not there had been an actual adverse effect on quality. Information obtained under this program would not be used for disciplinary purposes.

Information submitted would not be made available to the Professional Ethics Division for disciplinary purposes. The information would be made available to the reviewers of the firm in question when a peer review was to be made. It would be up to the reviewers to determine the extent to which the information would be taken into consideration in the planning of the peer review. If the reviewers believe the information to be erroneous or unfounded, they would give it little consideration. On the other hand, it might assist them in selecting those engagements or offices to be reviewed in testing compliance with the firm's quality control policies and procedures. The submission of the information would be acknowledged, but the person submitting it would receive no other indication of the use to which the information was put. The information would be solely for the purpose of helping the peer review team satisfy itself that the reported circumstances did or did not have an adverse effect on the ability of the firm to adhere to its quality control procedures and policies.

Referrals

The tendency of some who influence the selection of auditors to favor better known firms has been dealt with in other sections of this report. We have stated our conviction that a lesser known firm should not be displaced when it is satisfactorily providing all of the services needed by the client. When a client needs services which its CPA firm is not in a position to provide, firms have been encouraged to call in other firms which can provide the needed expertise.

We have been provided with examples of such referrals where representatives of a firm, which had been called in, proceeded to lure the client away from the referring firm. Although this practice does not violate any of the Rules of Professional Conduct, it certainly represents a breach of faith which severely limits the willingness of firms to call on other firms for help.

We believe that this practice is best controlled by the arrangements between the firms involved and recommend that firms which call in other firms have a clear understanding of the arrangements. That understanding could include an agreement not to provide additional services except with the consent of the referring firm.

We suggest that the AICPA Management of an Accounting Practice Committee develop a standard consulting contract to accomplish this objective.

Relations With Educators

Of primary interest to all firms is the subject of recruiting qualified professional staff members. Many practitioners in smaller firms feel that they are at a disadvantage in recruiting from colleges and universities because of the intensive recruiting efforts by larger firms. Larger firms are better able to predict their staffing needs and have the resources to maintain contact with faculty members at many colleges and universities. There is evidence that this may have created some

Problem

Small firms are less well-known on college and university campuses and opportunities available in smaller firms are not adequately known by accounting graduates.

Recommendation

AICPA should encourage more state societies and local chapters to sponsor "Local Practitioner Days" at colleges and universities within their territories.

bias on the part of educators, who, many believe, are inclined to steer graduates toward the larger firms.

Both the profession and accounting graduates would benefit if graduates are made aware of the opportunities that are available in firms of all sizes. This will result in a better matching of the characteristics of the firm with the qualifications and interests of the recruit.

Some local firms concentrate their recruiting efforts on one or two local universities, with the result that they are well known at those institutions and have less difficulty in recruiting highly qualified accounting graduates. As a practical matter, not all local firms can do this, and the committee concludes that state CPA societies and their local chapters are the logical organizations to provide the means for increasing contacts between local practitioners and accounting faculty members. We recommend that the AICPA take steps to encourage more state societies and their local chapters to sponsor local practitioner days at the colleges and universities within their areas. Such programs should be tailored to individual, local needs, but the purpose would be to have the local practitioners meet with faculty members, and perhaps with students, to get to know one another better. Through this means students can be made aware of career opportunities with smaller firms and can learn how to locate those firms. The firms will also be better aware of the means through which they can become acquainted with faculty members and plan their own recruiting efforts. Until these firms become better known to faculty and students, there can be no effective relationship between the practitioners, the educators, and the prospective recruits.

Accounting Curriculums

Problem

Faculty members are not as familiar as they should be with the challenges and opportunities in small and medium sized firms and accounting curriculums do not place sufficient emphasis on the type of practice encountered in these firms.

Recommendation

To enhance the understanding of faculty members of practice in smaller firms, both firms and faculties should seek ways for faculty to become involved in part-time assignments with local and regional firms.

There is concern among practitioners that the courses offered in colleges and universities are not as relevant to smaller firm practice as they could be. It is important for students to be told about career opportunities with smaller firms, and instructed on how to locate and approach small firms. It is also important that educators understand the different types of engagements students should expect to encounter and the need to monitor the curriculum to ensure students will be prepared for their professional assignments. We believe that a well rounded accounting graduate should be familiar with services such as compilation and review, which are a substantial part of the practice of many local firms, as well as the more sophisticated auditing and accounting subjects, which will be encountered in firms of all sizes.

To enhance faculty members' understanding of the requirements for practice in smaller firms, and to provide them with recent relevant experience, we recommend that both faculty members and smaller firms seek ways for faculty to become involved in part-time assignments with local and regional firms. Faculty members can participate in the in-house inspection of firms' quality control procedures and in-house training program. They can be used on consulting assignments and other types of engagements. This should benefit both the educators and the firms involved. The firms will have a valuable service performed for them and will get to know the educators better, thus improving their ability to meet and recruit accounting graduates. The professors will gain experience, which will help them to become more effective teachers and to impart to accounting students the challenges and opportunities available in smaller firms.

The Committee believes that modifications are in order to make the AICPA committees involved with relations with educators more responsive to the firms' needs. It is suggested that their membership be augmented with more representatives from local practice units. Further, it is recommended that the charge of these committees be re-examined to ascertain how they may help smaller firms communicate their needs and interests to the educational community.

Concluding Statement

The accounting profession serves a vital public need. Its members make substantial contributions to the credibility and reliability of financial information on which the economic system depends.

Almost two years of study have convinced the members of this committee that these needs are best served when the public has a free choice from among accounting firms of various types and sizes. The variety of services to be performed and the variety of entities for which those services are to be performed require an accounting profession made up of practice units which are local, regional, national and international.

The choice of an accounting firm should be based on the ability of the firm to perform the required services competently and for a fair fee. We believe that the clients are entitled to select accounting firms without undue pressure from underwriters or credit grantors as long as the selected firm can demonstrate its ability to perform the engagement in accordance with professional standards. Arbitrary policies on the part of underwriters, credit grantors, or others which favor, or discriminate against, any type of firm restrain the free choice which should be available to all entities engaging the services of certified public accountants.

We believe that even the largest companies should have an opportunity to choose from among many accounting firms. For that reason, there has been concern about the merger of smaller national firms into larger firms. On the other hand, there are indications that other firms grow to fill the void left by such mergers. Even though we may regret the further concentration caused by such mergers, we recognize that merger is one of the options open to accounting firms and that firms will merge when they feel it is in their best interests to do so. What we can do, however, is work to create a professional environment in which firms can maintain their status as local, regional or smaller national firms and not be put in a position of feeling compelled to consider mergers.

To create or maintain such a professional environment requires a strong national organization which is responsive to the needs of all segments of the profession. Those charged with the responsibility for setting professional standards must do so with full knowledge of the effect of those standards on privately held companies as well as the effects on publicly held companies. The benefits of each accounting and auditing standard should more than justify the costs of compliance. If they cannot, the standard should be modified so that it applies only to those types of entities which are likely to realize a benefit commensurate with the cost.

To assure that professional standards are appropriate for privately held companies, particularly the smaller ones, CPAs whose clientele is predominantly made up of small, closely held businesses must take part in the standard setting process. This requires an effort on the part of the American Institute of CPAs as the national professional organization, and it also requires substantial effort on the part of those who practice in small and medium sized accounting firms. AICPA and its members must accept this as joint responsibility.

AICPA has traditionally provided for smaller firms services which larger firms are able to provide for themselves. As the practice of professional accounting becomes more and more complex, the efforts of AICPA and the state societies to provide further services will be increased. This will require a continuing cooperative effort which will necessarily involve members who are not receiving a direct benefit from the services. Conversely, those who practice in the smaller firms should recognize that substantial AICPA resources must be devoted to the problems of the public securities markets, even though those problems may seem remote to some members. This type of cooperation has helped our profession grow in its capacity for service. This type of cooperation is essential to our future progress.

We reaffirm our belief that AICPA can continue to be responsive to the needs of each segment of our profession without placing undue burdens on the others. To attain this goal, there must be improved communications to and from the membership, and more active participation by committee members who are more representative of the membership at large, who can provide the means to assure that the views of all segments of the profession are heard and are ready to work to create a professional environment in which all firms will be judged on their merits.

If arbitrary restraints on the selection of accountants are eliminated, we are convinced that clients will seek out those firms best able to provide the services needed. Those firms may be small, medium sized or large, but the choice will have been a free one. Under these circumstances, we are convinced that well managed firms of all sizes have a place in the future of our profession.

No one can assure the prosperity or survival of any specific practitioner or firm. However, no evidence has come to our attention which would indicate that the future of small and medium sized firms is anything other than bright. Such firms have flourished in recent years, and we are confident that they will continue to flourish.

Throughout this Report, and in response to its charge, the Committee is recommending development of numerous programs to assure the ability of small and medium sized firms to retain clients of significant size and standing in the financial community in competition with large, national and international firms.

An Expression of Appreciation

The wide participation and helpful support accorded this committee by great numbers of members and organizations make it impractical to acknowledge them individually. Nonetheless, the Committee wishes to express its gratitude for all their efforts. In providing information and ideas, they have invested this report with whatever substance it has achieved. It is our observation that sponsorship of member forums by state societies, participation by members in these forums and in the five public hearings, and the letters and comments reaching us from numerous sources are all clear evidence of practitioners' deep interest in the profession and of their eagerness to improve their ability to serve the public and their clients.

Upon concluding our deliberations, we submit this report with the final recommendation that the AICPA Board of Directors move to assure that all the recommendations contained in our report be fully considered by appropriate committees or groups.

APPENDIX A

Firm Affiliations of Committee Members

Committee Member	*Firm Affiliation*	*Total Personnel*
Samuel A. Derieux, *Chairman*	Derieux, Baker, Thompson & Whitt	54
Lowell A. Baker	Meaden & Moore	79
George L. Bernstein	Laventhol & Horwath	2150
Alan P. Brout	Brout & Company	220
W. Thomas Cooper, Jr.	Frerman & Smiley	18
Curtis L. Frazier	Brantley, Spillar & Frazier	29
Glenn Ingram, Jr.	Glenn Ingram & Company	90
Morris B. Hariton	M.B. Hariton & Company	100
Charles Kaiser, Jr.	Pannell Kerr Forster	700
Bernard Z. Lee	Seidman & Seidman	1043
Alex L. Postlethwaite	Postlethwaite, Netterville, Evans and Major	65
Norman S. Rachlin	Rachlin & Cohen	82
Donald E. Schmaltz	Schmaltz & Company	18
Robert S. Siskin	Siskin, Shapiro & Company	77
Charles A. Taylor	Charles A. Taylor and Associates, Inc.	14

APPENDIX B

AICPA Members in Public Practice

Number of Members in Firm	*January 31, 1980*		*1974*		*1969*		*% Increase 1/31/80 over 1969*	
	Firms	*Members*	*Firms*	*Members*	*Firms*	*Members*	*Firms*	*Members*
One	19,421	19,421	11,426	11,426	8,798	8,798	121	121
2-4	6,522	16,811	4,755	12,157	4,176	10,616	56	58
5-9	1,667	10,452	1,025	6,442	770	4,827	116	117
10-19	507	6,609	263	3,311	189	2,397	168	176
20-29	87	2,043	41	949	25	588	248	247
30-49	49	1,813	16	538	14	504	250	260
50-75	9	557	9	407	4	249	125	124
76-100	2	180	5	436	3	270	(33)	(33)
101-500	11	1,852	12	3,064	10	2,295	10	(19)
501-2000	5	4,055	5	5,665	7	10,107	(29)	(60)
over 2000	8	21,378	6	15,076	1	2,114	700	911
Totals	28,288	85,171	17,563	59,471	13,997	42,765	102	99

APPENDIX C

Technical and Managerial Assistance of Interest to Smaller Firms

Services

Studies and Guidelines are issued by Accounting Standards, Auditing Standards, Federal Taxation, Computer Services and Management Advisory Services Divisions, and by the Accounting and Review Services Committee.

Technical Information Service responds to member inquiries about any practice problems, except tax and legal questions.

Continuing Professional Education includes AICPA seminars and workshops and in-house CPE materials.

VideoFlex is a series of video-assisted CPE programs combining video instruction with a coordinated workbook/manual.

CPE Standards Department responds to member inquiries about individual and firm requirements to meet statutory or recommended CPE standards.

Computer Services Division assists members in locating sources of software packages for particular applications or hardware configurations.

AICPA Library researches member requests for information, provides bibliographies, loans material by mail, and offers microfiche service containing annual reports of 6,500 companies.

National Automated Accounting Research System (NAARS) is provided for research of financial statements, footnotes, auditors' reports from thousands of annual reports, authoritative literature, and selected proxy material.

Management of an Accounting Practice (MAP) responds to member inquiries about firm management and administration.

MAS Small Business Consulting Practices Subcommittee assists in identifying and solving smaller company problems.

Practice Review Program offers the opportunity to improve reporting practices by submitting a report and related financial statements for comment.

Technical Standards Review Program offers an in-house, post-issuance critique of working papers and reports for audited, unaudited, and compiled and reviewed financial statements.

Quality Control Document Review Program offers a confidential examination of a firm's quality control document.

Local Firm Management Review Program for the opportunity to have administrative practices evaluated by a team of fellow practitioners.

Division for Firms provides a new system for self-regulation and directs greater attention to meeting the differing needs of privately owned and SEC clients.

Publications

Publications and Individual Study Courses. A 92-page annual catalog listing all publications, subscription services, recorded materials and individual study programs available from AICPA.

CPE Catalog. AICPA's comprehensive reference listing of 3,000 group study presentations and 150 individual study courses.

Practicing CPA for short items on practice management and practical applications of professional standards for local practitioners.

CPA Letter provides members with information about current technical and professional developments.

Tax Adviser for tax articles, interpretation, tax planning pointers, recent developments.

CPA Client Bulletin, monthly newsletter for distribution to clients.

APPENDIX C

Journal of Accountancy offers "Practitioners Forum" column and major articles on practice management.

MAP Handbook, a looseleaf service on all aspects of management.

Audit and Accounting Manual, a looseleaf and paperback service offering practice aids.

Manual on Practice Management Roundtables, shows local practitioners how to set up roundtable-type conference.

**MAP Recruiting Brochure* offers assistance in recruiting for small firms. (Upcoming in 1980).

Conferences

National Conferences are held each year on accounting and auditing, private companies practice, management advisory services, federal taxation, data processing, banking, and savings and loan associations.

Practice Management Conferences. Four are held each year on aspects of partnerships and professional corporations, practice growth and development, firm management and administration, people management.

Quality of Life Conference helps CPA resolve conflicts between professional and personal life.

***Sole and Smallest Practitioner Conference.* Under consideration. If approved, Industry & Practice Management would present within a year.

***Workshop on Practice Management.* Under consideration. Is week-long, hands-on workshop.

***Performance Standards for Managing Partners.* Possible conference, possible publication of study on role of managing partner under consideration.

Small Business Development Committee Conference. Feb. 6, 1981. Regarding joint engagements between large and smaller firms, per Executive Order.

*Upcoming
**Under consideration for possible presentation in 1981.

Communications

Public Relations Division conducts information programs using all media to inform the public about the profession and its developments. Also, prepares and coordinates through state societies issuance of consumer-oriented programs that describe practitioners' services.

CPA VideoJournal. A monthly videotape of interviews, discussions and commentaries on new standards, and other professional developments.

Member Forum Program offers members opportunity to state views on issues under consideration by AICPA committees.

Local Practitioners Seminars, annual series of three seminars offers local practitioners the opportunity to discuss professional issues with AICPA president.

Speakers Referral Service and *Field Trip Program* enable committee members and staff to meet with local practitioners to better understand needs and problems of practicing CPA.

Professional Recognition

Washington Office monitors federal legislation and regulations, submits comments on matters affecting small firms.

Relations With Educators Division develops recruiting literature, and through its Accounting Testing Program, offers firms tests for personnel evaluation.

State Legislation Department works closely with state societies on accountancy legislation.

Uniform CPA Examination, prepared by the AICPA with an advisory grade issued for the state boards of accountancy.

APPENDIX D

Information on Meetings Held

Member Forums

Member Forums were held in cooperation with the following state societies during the period May through September 1979:

Alabama	Indiana	Mississippi	Oklahoma
Alaska	Iowa	Missouri	Pennsylvania
Arkansas	Kansas	Montana	South Carolina
Connecticut	Kentucky	Nevada	South Dakota
Delaware	Louisiana	New Hampshire	Tennessee
Florida	Maine	New Jersey	Texas
Georgia	Maryland	New York	Virginia
Hawaii	Massachusetts	North Carolina	Washington
Idaho	Michigan	North Dakota	West Virginia
Illinois	Minnesota	Ohio	Wyoming

Public Hearings

On November 27, 1979, members of the committee held simultaneous public hearings in Atlanta, Chicago, Dallas, Los Angeles, and New York.