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Future of the Small Accounting Firm

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The Future of the Small Accounting Firm*

By Eustace LeMaster

There is no reason to become alarmed about the future of the small accounting firm. A review of the conditions that culminated in serious losses to the small firms last year shows that the position of the small firms needs strengthening, but it is by no means hopeless.

The position of the small accounting firm has been assailed on three sides. Large manufacturing corporations have organized subsidiary accounting corporations for the purpose of auditing the accounts of their dealers; banks have organized accounting departments to make surveys of the accounts of prospective borrowers; and there has been an increasing tendency on the part of those who control accounting assignments to give preference to the large accounting firms.

Unquestionably, many local firms have lost much business to the so-called national firms. When speaking of losses, I include the failure to receive a just proportion of new business as well as actual losses of old business.

The period of inflation just passed played havoc with the practice of many small accounting firms. The national firms acquired many profitable assignments which had been handled by local accounting firms. This condition was due primarily to the unprecedented opportunity investment bankers were given to dictate the assignment of accounting work in mergers, consolidations and expansions. Local accountants have felt aggrieved and have voiced severe criticism of investment bankers for what the local accountant felt was unjust discrimination.

In spite of the fact that the work of many local accountants is equal to the average work performed by the national firms, investment bankers can not be charged with unjust discrimination. In choosing national firms, investment bankers have merely followed the line of least resistance.

The chief concerns of the investment bankers with respect to accounting service are: first, reliability of information; second, the general recognition of the accountant; third, prompt service; fourth, low cost.

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Investment bankers are busy and human. In seeking accountants or recommending accountants, they naturally turn to those with whom they are personally acquainted. The national firms have availed themselves of their opportunities to effect personal acquaintanceship. The result is, the investment banker does not take time to investigate and to determine the professional merits of individual local firms, except on rare occasions.

The primary problem of the investment banker is a sales problem. He tries to select an accountant whose name in his prospectus will be immediately recognized by the public. He does not feel that he can risk the creation of sales resistance by using local accountants whose names are not generally known.

Speed and cost go hand in hand. The national firms with their highly organized staffs, usually render prompt service. Unfortunately, this is not always so with local accountants. Per-diem rates are not the measure of the cost of accountants' services. Ultimate fees and timely reports are far more important than the charge by the day.

The national firms naturally secure assignments national in their scope. The successful handling of a large scale audit in many cities at once requires a careful coördination of staffs under one head with the power to command immediate obedience to orders. I think we shall never see the day when a group of small accounting firms will be able to carry a large audit to a speedy and successful conclusion. The utter lack of uniformity of working papers, audit procedure, reports and other technical matters makes the use of correspondents unwieldy, slow and consequently costly.

So much for the reasons why investment bankers choose national firms rather than local accounting firms.

Prior to the period of inflation, and extending through it to the present time, there has been a tendency on the part of the larger commercial banks to favor the national accounting firms over local firms. While the small firm's losses resulting from this favoritism have not been so severe as those resulting from mergers and consolidations, they have been continuous and have extended over a longer period of time. The steadiness and persistence of these losses have been discouraging to many of the smaller firms. Try as they might to establish reputations for reliability, many reputable accountants have been dismayed to see commercial bankers recommending national firms to local business men to the exclusion of local accountants.

Neither the efforts of the national firms nor the bankers are wholly to blame for the condition.

The relation of the accountant with those who have occasion to use the results of his service is one requiring a high degree of confidence and trust. Frequently, the confidence and trust of third parties not privy to the contract of employment are far more important than the confidence and trust of the persons actually paying for the accounting service. In many cases, the third party has more to say about the employment of the accountant than the man who actually pays the bill. It follows then that a general reputation for skilled and trustworthy service is one of the principal assets of the small accounting firm.

Unfortunately, this principle has not been recognized by all accountants. In fact, there are men holding themselves out as public accountants who are not qualified to do so, either morally or technically. The prevalence of untrustworthy work has compelled commercial bankers to prepare black lists of accounting firms. One of the leading bankers in my home city classifies accountants under two headings: those who make statements as the clients want them, and those who do not. The length of the list of local firms classified as making statements as the clients want them is by no means evidence of the general trustworthiness of local firms.

A banker of my acquaintance has just lost a considerable sum of money through the failure of a large commercial firm. The banker had lent money and had renewed loans on the strength of a local accountant's report. The company failed and an audit by a national firm revealed the fact that the local accountant had materially understated the liabilities. The local accountant had been careful to cover himself by qualifications, but he had neglected to do that which is ordinarily required of an accountant in the verification of liabilities. In other words, the local accountant had been zealous in his efforts to keep his fee low, to please the man who paid him and to avoid personal liability by means of qualifications. If he had been equally zealous in his consideration of the interests of those not privy to his contract, many thousands of dollars would have been saved. The banker in commenting on this case, tapped a pile of reports and said, "This is going to hurt all of the local accountants—severely", and he meant it.

It does no good to cite the injustice in the condemnation of all local accountants for the poor work of some of them. The fact remains that it is easier for the busy banker to recommend reputable national accounting firms instead of making the investigation necessary to determine the trustworthiness of small accounting firms suggested to him.

There is no good reason why reputable local accountants should not have the greater part of the local accounting practice. The advantages the local accountant enjoys in opportunity to serve his client are too well known for me to enumerate them here. Suffice it to say that the accountant renders a minimum of service when he merely signs a certificate to a statement of financial condition. And many business men are deprived of the treasures that rest in the rich experience of capable accountants who live in their own home town.

Summarizing what has been said before, the principal obstacle in the way of a healthy growth in the business of small accounting firms is the rather widespread lack of confidence in local accountants as a class.

The prevalence of untrustworthy accounting work can be traced directly to the utter lack of control exercised over the individual accountants either by legally constituted authority or by the profession itself.

What I have to say next must not be construed as an attack on certified public accountants or C. P. A. legislation. My remarks are made with the hope that legislation may be enacted that will make the licensing of accountants an effective safeguard to the public.

The licence of a certified public accountant is, in most states, an empty title which affords no protection whatsoever to the public. In my own state, an attorney recently stated in an address to a jury: "All that is required in this state to become a certified public accountant is that you be nineteen years old, of good moral character and pass an easy examination. Why these C. P. A.'s are nothing more than glorified bookkeepers. The licence may be revoked for cause, but the maximum punishment for violation of the statute is a fine of one hundred dollars." The statement is exaggerated, but not uncalled for. The licence is revoked or suspended only after long and expensive hearings. The revocation of a licence does not bar the offending party from continuing to practise as a public accountant. Aggrieved persons have found that both legal and practical obstacles nullify theoretical remedies against erring accountants for damages suffered. Is it any wonder that bankers would rather rely on the reputations of a few large firms than on the fact that a man is a certified public accountant?

This situation can be corrected by uniform accountancy legislation which will provide among other things:

1. That licensed accountants only shall be permitted to practise accountancy.
2. That moral, educational and experience qualifications shall be high.
3. That the punishment for incompetence, negligence and dishonesty shall be speedy and sure.
4. That damaged persons shall be provided with adequate remedies.

The situation has been known for a long time to professional accountants, and many have been the attempts to correct it. The repeated failure of accountants to secure remedial legislation are due primarily to the fact that there is no public demand for adequate accounting legislation. The voting public is not acquainted with the work of accountants, much less with the need for control over the profession. Many legislators, unless selfishly interested, are not concerned in any legislation that does not result in votes. In other words, many modern legislators are engaged principally in the business of vote getting.

It can be seen readily that I am not particularly optimistic about the passage of adequate legislation, even in my life time. But, that is no reason why we should cease in our efforts to secure the passage of good accountancy legislation.

In the meantime, through the existence of an organized group whose reputation for reliability will be generally recognized, professional accountants must depend upon the profession itself to overcome the lack of confidence in local accountants generally. The banding together of reputable accountants in a society which, jealous of its reputation, shall carefully select its members, set standards of ethics, carry out educational programmes, exercise strict control over its members, and speedily dismiss those who prove themselves not worthy of the honor of membership, is the only method by which reputable accountants may remove themselves from a section of the profession that is now more or less under a cloud.

The existence of a strong organization will do much toward removing the prejudice of financial houses against local accountants; it will remove most of the hazards that large financial institutions now incur in the acceptance of certificates from local accountants; and it will eventually result in the general acceptance of the reports of small accounting firms without question, provided the report is signed by a member of the group.

I sincerely believe that the American Institute of Accountants is such a society and that it has achieved some success in establishing for its members a general reputation for reliability. Small accounting firms throughout the United States have not fully realized that the American Institute of Accountants is in a position to render them a great service. I wish that we could impress the small accounting firms with the importance of coöperative action, to the end that principals of all reputable accounting firms could be counted in the membership of the American Institute of Accountants.

I have faith in the future of the small accounting firm because of the existence of the American Institute of Accountants. It is essential to continue our faith in the ideals of the Institute, and to let nothing influence us to lower the standards we have set for our members. Let us carry on.