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# The Changing Profession: End of the Small Practitioner?

*By Marvin J. Albin, Ph.D., CPA and James R. Crockett, DBA, CPA CIA*

Professional requirements associated with CPAs who perform audit and review services have increased significantly over the past three years. The Statements on Auditing Standards (SAS) issued by the AICPA to address the "Expectation Gap" [AICPA 1988] imposed stricter requirements and in some cases caused fundamental changes in the way audits are conducted. The peer review requirements voted in by the AICPA membership [AICPA 1989] for those engaged in audit and review services resulted in additional demands and costs. The legal environment in which audit and review services are performed is unstable in the face of a rapidly changing economy and stiffer professional requirements. In combination, these factors raise the question of whether CPA firms with limited resources and clienteles consisting primarily of small businesses will find it viable to continue offering audit and review services. This article reports the results of a research project designed to evaluate how changing conditions have affected the audit and review practices of local CPA firms in a five-state area of the Midsouth.

## **Research Methodology and Summary of Results**

A questionnaire (Figure 1) was developed to secure information from local CPA firms. The questionnaire was mailed to 529 firms selected from telephone Yellow Pages of 23 metropolitan areas – five each in Mississippi, Louisiana, Tennessee, and Alabama, and three in Arkansas. In selecting firms to be surveyed, attempts were made to choose those whose Yellow Page listings indicated they performed audits and to avoid those who appeared to practice in more than one state.

There were 189 usable responses received out of 529 surveys, resulting in a response rate of 36 percent. The response rate was high for the population surveyed,

reflecting a great deal of interest in the subject. The level of concern among local practitioners was reinforced by comments written on the responses and telephone calls to the authors. The responses clearly indicate that the changing professional environment is having an important impact on the audit and review practices of local CPA firms in the region. This is exemplified by the following summary data concerning the respondent's firms: (Note: Not all of the 189 participants responded properly to every survey item.)

1. A total of 35 out of 187 respondents (19 percent) indicated their firms do not perform audits. Twenty-eight of these discontinued their audit practice during the past two years.
2. Twenty-three respondents indicated their firms are planning to discontinue performing audits.
3. Twenty-nine respondents indicated their firms were undecided about whether to discontinue performing audits.
4. Thirteen respondents indicated their firms had discontinued performing reviews during the past two years, while seven indicated their firms planned to discontinue such service.
5. Fourteen respondents indicated their firms had gained audit or review clients during the past two years from firms that had discontinued performing such services.
6. Respondents who had discontinued or planned to discontinue audit or review services indicated that peer review requirements, decreased profitability, new professional standards, and the legal environment all had contributed to their decisions to discontinue.
7. Respondents strongly indicated that new professional standards, peer review requirements, and the two in combination will make audits impractical for small firms and audits and reviews too expensive for some clients who have used such services in the past.

### **Impact on Audit Services**

A more detailed look at the survey results better reflects the changes in audit practice. From the perspective of audit services, 42 percent of the firms with audit practices (65 of 152) have already been affected significantly by the changing environment. These firms have either discontinued audits, plan to discontinue, or have gained clients because other firms have discontinued performing audits. An additional 19 percent (29) of the respondent firms were undecided as to continuing to perform audits. Thus, potentially 61 percent of the respondent firms' audit practices either have been, or will be, significantly affected by the changing environment.

Sole practitioners responding to the survey indicated their audit practices are being severely affected. Twenty-eight (42 percent) of the 66 sole practitioner respondents discontinued conducting audits during the past two years. Another 17 (26 percent) indicated they plan to discontinue audits. Thus, a total of 45 (68 percent) are either out of audit practice or plan to discontinue. In addition, 15 others indicated they were undecided about continuing their audit practice. It should be noted that all of the respondents (28) who indicated their firms had discontinued audits during the past two years were sole practitioners.

### **Impact on Review Services**

The review practices of sole practitioners are also being severely affected. Seven (10 percent) of the 69 sole practitioners responding indicated they had discontinued performing review services during the past two years. Another six (9 percent) indicated they planned to discontinue. An additional 22 (32 percent) indicated they were undecided about whether or not to continue performing reviews. Thus, 51 percent of the sole practitioner respondents had discontinued, planned to discontinue, or were undecided about review services.

While review services of respondents' firms have been affected, the impact does not appear to be as drastic as audit services. This can likely be attributed to the differing

levels of peer review that are required for AICPA membership for audit and review services. Audit practice requires an on-site peer review every three years, with an estimated average cost of \$1,200 for sole practitioners. Review services require an off-site or desk review every three years, with an estimated average cost of \$750 for sole practitioners [Cottle 1988].

### **Change Factors**

The questionnaire asked respondents whose firms had discontinued or planned to discontinue audits or reviews to rate four items as to their importance in the decision to discontinue. The rating scale was 1 to 5, with 1 indicating the item was very important and 5 indicating it was of no importance. The items and their mean ratings were as follows:

1. The legal environment = 2.61
2. The AICPA's peer review requirements = 2.01
3. The requirements imposed by new SAS = 2.35
4. Decreased profitability of such engagements = 2.34

Assuming a response of 3 to be neutral, a mean below 3 would indicate that the item was generally felt to be important. Thus, respondents generally believed that all of the items were important with respect to their decisions; the AICPA's peer review requirements were considered the most important. It is interesting to note that, overall, the legal environment was considered to be the least important. It appears decreased profitability is probably a result of a combination of the other three factors.

The questionnaire asked respondents to indicate their level of agreement with three statements concerning the practicality of small CPA firms continuing to offer audit and review services. A scale of 1 to 5 was used, with 1 indicating strong agreement and 5 indicating strong disagreement. The statements and the mean values of the responses were:

1. The requirements imposed by the new SAS will make auditing impractical for small firms = 2.38
2. The AICPA's peer review requirements will make audit and review engagements impractical for small

firms = 2.46

3. The costs associated with complying with the new SAS and peer review will make audits or reviews too expensive for some clients who have used such services in the past = 2.21

Each mean value was below 3, indicating respondents generally agreed with all three statements. There was strong agreement with the statement concerning the expense of reviews for some clients.

### **Respondent Comments**

Fifty-eight (31 percent) of the respondents added written comments to the questionnaire. The majority of these comments were decidedly negative and came primarily from sole practitioners and small partnerships or professional corporations. The following are typical comments:

It should be noted that 11 (6 percent) of the respondents indicated they expected to give up their membership in the AICPA as a result of the effect of restructuring their practices.

### **Conclusions and Implications**

Small CPA firms are being greatly affected by the changing professional environment. Many firms are giving up the auditing and review parts of their practice. This is especially true of sole practitioners. It appears that sole practitioners believe that they either cannot, or cannot afford to, live up to the requirements of the new SASs and peer review. The legal environment, peer review requirements, new professional standards, and decreased profitability all contributed to this phenomenon. Overall, study participants believed the new professional standards and peer review requirements together are rendering audit and review services too expensive for some clients who have previously used these services.

There are some interesting implications to these findings:

1. In the face of the recent crises in banking, it appears that bankers will require audits or review for more of their clients before granting credit. With decreasing availability and increasing costs of these services, worthy small

business may not be able to obtain needed credit. This has ominous implications for the economy.

2. As noted earlier, the legal environment was considered the least important factor contributing to decisions to discontinue audit and review services. This implies that respondents believe the users of such services were generally satisfied. In turn, the respondents' clients were receiving useful professional services at affordable prices and the new professional requirements were unnecessary. The pressures resulting in discontinuance are coming from the profession itself.

While the authors seriously doubt there is a conspiracy to

drive small practitioners out of auditing, there certainly seems to be such a perception among the respondents. There is no question that the new SASs and peer review will result in higher quality services. There is a real question as to whether a higher quality of service is cost-justified for clients of small practitioners.

3. Small practice units are apparently being shut out of a professional aspect of accounting practice, i.e., audit services. Their practices are being limited to financial statements, tax practice, and small systems work, none of which require a CPA certificate in most states.

The authors question whether the accounting profession and society as

a whole will benefit from what is happening to small CPA firms.

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AICPA (1988). Statements on Auditing Standards nos. 53, 54, 55, 56, 57, 58, 59, 60, 61.

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Cottle, David W. "The AICPA's Plan to Restructure Professional Standards: How the Requirements Affect You" the Practical Account (April 1988).

**Figure 1**

1. In which state is your firm located? .....	AL 49	AR 25	LA 42	MS 36	TN 34	MULTI STATE 3
2. What is the form of your practice?						
70 Sole practitioner						
53 Partnership (number of partners _____)						
65 Professional corporation or association (number of shareholders _____)						
3. Are you or any partner or shareholder in your firm a member of the AICPA? ....	YES 180	NO 8	MULTI STATE 1			
4. Does your firm conduct financial statement audits under generally accepted auditing standards (GAAS)?						
.....	YES 152	NO 35	MULTI STATE 2			
5. Does your firm conduct reviews under the statements on standards for accounting and review services (SSARS)?						
.....	YES 154	NO 33	MULTI STATE 2			
6. Has your firm discontinued conducting audits during the past two years? .....	YES 28	NO 156	MULTI STATE 5			
7. Is your firm planning to discontinue conducting audits in the near future?						
.....	UNDECIDED 29	YES 23	NO 117	MULTI STATE 20		
8. Has your firm discontinued conducting reviews during the past two years? ....	YES 13	NO 171	MULTI STATE 20			
9. Is your firm planning to discontinue conducting reviews in the near future?						
.....	UNDECIDED 34	YES 7	NO 130	MULTI STATE 18		
10. If your firm has discontinued, or plans to discontinue, conducting audits or reviews, please indicate the importance of each of the following factors in the decision to discontinue. Circle the number most closely reflecting your opinion. (1 = Very Important; 5 = No Importance).						
	1	2	3	4	5	
a. The legal environment.	24	11	14	10	11	
b. The AICPA's peer review requirements.	39	11	10	3	8	
c. The requirements imposed by the Statement on Auditing Standards issued in 1988 and 1989.	22	21	17	3	8	
d. Decreased profitability of audit or review engagements.	29	14	12	4	11	
11. During 1988 and 1989 did your firm gain any audit or review clients from firms that have discontinued such engagements? .....	YES 14	NO 167	NUMBER 8			
12. Please indicate the extent of your agreement with each of the following statements. Circle the number most closely reflecting your opinion. (1 = Strongly Agree; 5 = Strongly Disagree)						
a. The requirements imposed by the new Statements on Auditing Standards will make auditing impractical for small CPA firms.	63	46	36	18	20	
b. The AICPA's peer review requirements will make audit and review engagements impractical for small CPA firms.	64	39	39	21	23	
c. The costs associated with complying with the new Statements on Auditing Standards and peer review will make audits or reviews too expensive for some clients who have used such services in the past.	74	44	34	21	12	