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CPA in Management Services: A Survey and Projection

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This article traces the reasons for the involvement of CPAs in management services and explains the reasoning behind the view that the variety of services the CPA will be called on to perform will become more and more extensive in the future —

THE CPA IN MANAGEMENT SERVICES: A SURVEY AND PROJECTION

by H. G. Trentin
Arthur Andersen & Co.

SERVICE industries such as banks, finance companies, insurance companies, leasing organizations, and many others are fast assuming a major role in our economy. The forty-fifth annual report of the National Bureau of Economic Research points out that ours is the first country to reach the point where more than half of the employed population is engaged in rendering services rather than in producing goods and where more than half of the gross national product comes from services.

Consulting is among the services that are experiencing substantial growth. Although accurate figures are not available, fees from consulting activities certainly exceed $100 million a year, and some estimates put them much higher. Who are these consultants and what role does the CPA play in the consulting field?

The American Management Association's Directory of Consultant Members classifies consultants as follows: financial management, general management, insurance management, manufacturing management, marketing management, office management, administrative services, packaging, personnel management, purchasing, research and development, general consultants in management, and consultants in other fields. Hundreds of names are included in the directory. None of them, of course, is a CPA or a CPA firm since the traditions and ethics of that profession prohibit such directory listings.

In his book *Self Renewal — The Individual and the Innovative Society* John W. Gardner, formerly president of The Carnegie Foundation and now Secretary of Health, Education and Welfare, has the following comments to make about consultants:

"Another development that has profoundly altered the nature of the classic bureaucracy (large-scale industrial and governmental organizations) is the extraordinary rise of servicing organizations. The large modern organization is invaded every hour of the day and night by armies of people performing one or another sort of service. Just as the crocodile has a bird that picks its teeth and parasites in its digestive tract, so the modern large-scale organization is picked over and used as a support-

ing environment by an incredible variety of outsiders. Lawyers, auditors, management consultants, architects, decorators, insurance men, bankers, public relations men, advertising men, plant security people, janitorial services, landscape architects and an endless list of others move in to contribute their highly specialized bits to the complex functioning of the whole — and then move out again. They are a vital part of the human environment and the functioning of the machinery, yet they never appear on the organization chart, and their only relationship to the organization is of a contractual nature.

"The remarkable range of such professional and technical services that are available, plus the flexibility of the contractual relationship, gives the modern organization a wide range of choice in shaping its own future. Within limits, top management can put its finger on almost any function within the organization and decree that henceforth that function will be performed by an outside organization on contract. For the organization that wishes to maintain the maneuverability so essential to renewal, this offers priceless opportunities.

"Particularly interesting are those instances in which the very nature of the large organization makes it necessary to reach outside for assistance. Much of the effectiveness of the management consultant, for example, is traceable to his 'outsidedness.' Much that he does could — in theory — be done by specialists within the organization, but he has the advantage of operating outside the stultifying forces which hem them in. He can take a fresh view. He can speak out. And he may be listened to.

"Furthermore, since professionals often do not enjoy life in the large organization and do enjoy the environment of a professional team, the servicing organization is usually able to retain a higher grade of specialist than its clients could normally recruit or hold."

Incidentally, I recommend this book in its entirety (127 pages, Harper & Row) to every CPA for its insight into the human aspects of improvement and renewal, which are the essence of a consultant's objectives.

Areas of practice

CPAs, of course, do not provide consulting services in all the fields cited by AMA or by Mr. Gardner. However, although there may be some differences of opinion on this matter, we would venture the guess that there would be a wide area of agreement among the CPA firms that have most of the management services practice that the following are appropriate fields of activity for CPAs:

- General accounting systems
- Cost accounting systems
- Budget systems
- Financial planning and control systems
- Management information systems
- Mechanization of data processing —
  - Bookkeeping machines
  - Punched card systems
  - Electronic computer systems
- Marketing information and quantitative decision systems
- Production and inventory control systems
- Operations research techniques to aid in economic decisions and business problem solutions

Some CPAs practice in broader fields, with areas of activity that in many respects resemble those of the management engineers or consultants. Ever since the publication about ten years ago of the first AICPA classification of management services there has been intense and useful debate within the

Management can decree that almost any company function be taken over by outside specialists.

The conservative CPA stays close to traditional financial fields in management services; the liberal gets deeply involved in industrial engineering techniques.

profession as to the types of assignments which CPAs should undertake.

The most conservative views adhere to a concept of practice that is oriented largely toward management accounting or management information systems. This would include financial planning and control systems such as budgeting, responsibility and profitability reporting, cost accounting, and capital appropriations analysis; mechanization of data processing systems related thereto; and similar activities.

The most liberal views favor practice in areas of industrial engineering involving measurements and setting of standards for cost accounting and production control systems, plant layout, personnel recruiting and testing, organization development, market research, and similar activities.

All CPAs are agreed, however, that they should not undertake assignments or perform in roles that will impair their independence as certifying accountants or tarnish the image of the profession's objectivity in evaluation of the financial statement presentations of management.

Like other professional men, the CPA has been expanding his scope of practice steadily over the years. The growth of the management services practice began to assume important proportions in the 1930s, when punched card equipment spread through business, and received increased impetus after World War II with the advent of computers and advanced management techniques.

Surprisingly, this growth has been more the result of responding to the demands of business than of any concerted promotional effort on the part of CPAs. As businesses grew in size and complexity and more advanced management techniques were developed by professional firms, businessmen sought outside help to a greater extent.

Significantly, they turned increasingly to the CPA, who had earned the confidence of the businessman as auditor, financial advisor, and tax advisor and who also had a reputation for professional integrity and independence. Since many of the management services assignments involved planning and control systems that relied heavily on accounting and related statistical information, and on the means for processing such data, the progressive CPA found it a relatively natural development to move into this new area by acquiring the needed added competence.

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Broadening of accountants' role

The initial role of accountants was primarily that of making a record of financial transactions so that owners of the business could understand the causes of increase or decrease in their fortunes and so that auditors could independently check the record for accuracy. As busi-

nesses became more complex, accountants were drawn away from this historical and custodial function to some extent and into greater service to business managers in providing information for interpreting the results of operations and deciding future courses of action. This change, in the main, was caused or accompanied by the following developments, most of which date from World War II:

1. The increased emphasis on quantitative analysis for business decisions
2. The greater appreciation of the role of a management information system in business planning and control
3. The advent of electronic computers.

These developments – and the natural suitability of the accountant to participate in them—will now be discussed briefly.

The work of the operations researcher and the accountant in the field of business decision making are closely related; as a result the accountant has had to learn more about mathematical methods. . . .

Quantitative analysis

The story of how operations research techniques helped solve some of the military problems of the last war and how they have been applied to the solution of business problems in the postwar era is a familiar one. As applied to business, operations research involves the study of costs and revenues that are likely to result from various alternative decisions in uncertain or complex business situations. The purpose of such studies is to develop systematic procedures that will provide business executives with effective information to assist them in making the decisions that guide and control their enterprises.

Accountants are, of course, immersed in the study of costs and revenues and in helping management to develop projections of future costs and revenues. Operations research people may develop similar projections, but their efforts are directed more toward studying and analyzing costs and revenues in such a way as to discern (1) significant and available decision alternatives at various levels of organizational responsibility and (2) logical relations among the factors inherent in specific business problems. From an understanding of decision alternatives and the logical relationships that are involved, the operations researcher tries to develop systems that will give management useful bases for making choices among specific alternatives.

It is obvious that the work of the operations researcher and that of the accountant in business decision making are closely related. As a result the accountant has had to learn more about mathematical methods and in some cases has had to establish close working relationships with highly trained operations research men.

Business managers continually make decisions about purchases, selling prices, products, people, acquisitions, and many other things that involve varying degrees of uncertainty about all of the pertinent facts and about all of the probable consequences of the decisions. Usually they achieve the right balance between waiting for more information and making quick decisions—but the vast majority wish that more pertinent and timely information could somehow be made available on an economically feasible basis.

The vital relationship between information and decisions has led to great preoccupation with management information systems. Business literature in recent years has abounded with discussions of the need for and nature of such systems and the importance of the contribution the flow of accounting data makes to the information stream.

Simply stated, a management information system comprises a set of reports specially designed to help management make planning and control decisions.

Examples of some of the important elements which comprise such a system are the following:

1. Reports of historical company and environmental data for long- and short-range planning
2. Long- and short-range financial and operating budgets

3. Monthly financial and operating statements on a "responsibility" basis

4. Sales and order entry statistics, which provide input to many other systems dealing with sales quotas, salesmen's compensation, purchasing, manufacturing, shipping, and others

5. Reports to service the various control systems such as these:
   (a) Sales forecasting
   (b) Shipping and warehousing
   (c) Finished goods replenishment
   (d) Production control
   (e) Materials management
   (f) Manufacturing cost control
   (g) Personnel skills and manning control
   (h) Management incentives

6. Feedback showing what changes should be made in the financial plan in view of actual results to date or what would happen to net income if hypothetical changes were made in the plan.

The high financial data content of these systems is readily apparent.

The rapid spread of the electronic computer throughout business in recent years is the result of its ability, when properly used, to improve management effectiveness, reduce costs, and improve profits. This has been accomplished largely through the computer's role in the developments previously discussed.

Electronic computers have been extremely useful to operations researchers because of the predominantly mathematical character of many of their techniques. For example, consider the use of linear programing, which is an analytical or computational technique for solving a general class of optimization problems involving many variables related in a complex way. The solution of these problems involves the attainment of a measure of effectiveness such as profits, costs, or quantities produced for a given set of restraining conditions, e.g., material availability, production capacity, government regulations, etc.

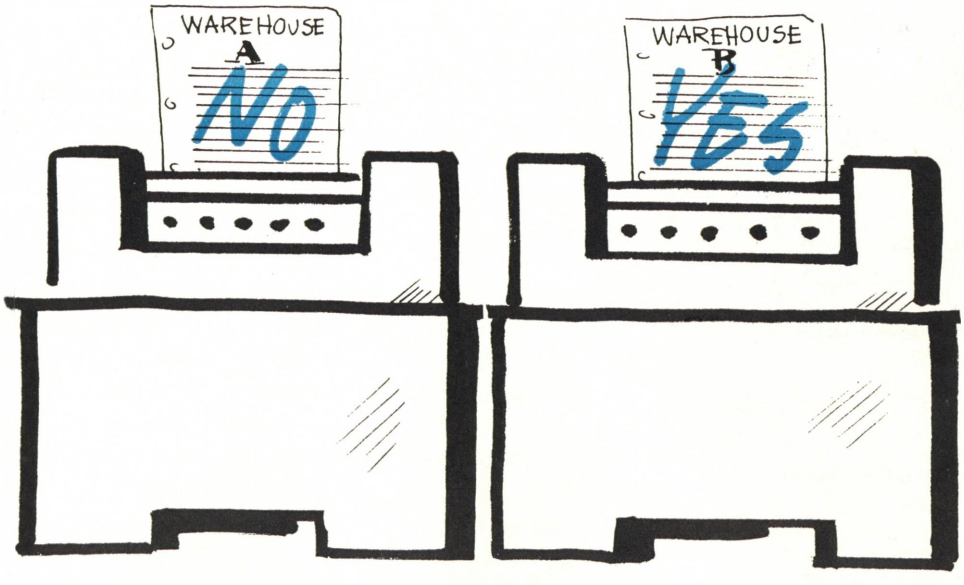
In a specific case, the linear programing technique may systematically search through unit cost and quantity tables of hundreds of alternatives for making products at various plants of a national company, shipping to and storing at various warehouses, and ultimately shipping to customers in order to arrive at an overall minimum-cost solution.

Computers also have made it possible to collect and disseminate more information more quickly and economically, and if they are used to process properly designed information flows, they can help achieve better management information systems. This is particularly true in the case of large companies with many operating locations throughout the country. In such cases, large centralized "figure factories" employing computers and serviced by communications networks have been established to serve as management information centers of the enterprises. In such cases the information can be used centrally for decisions or transmitted to the operating locations for decentralized decisions.

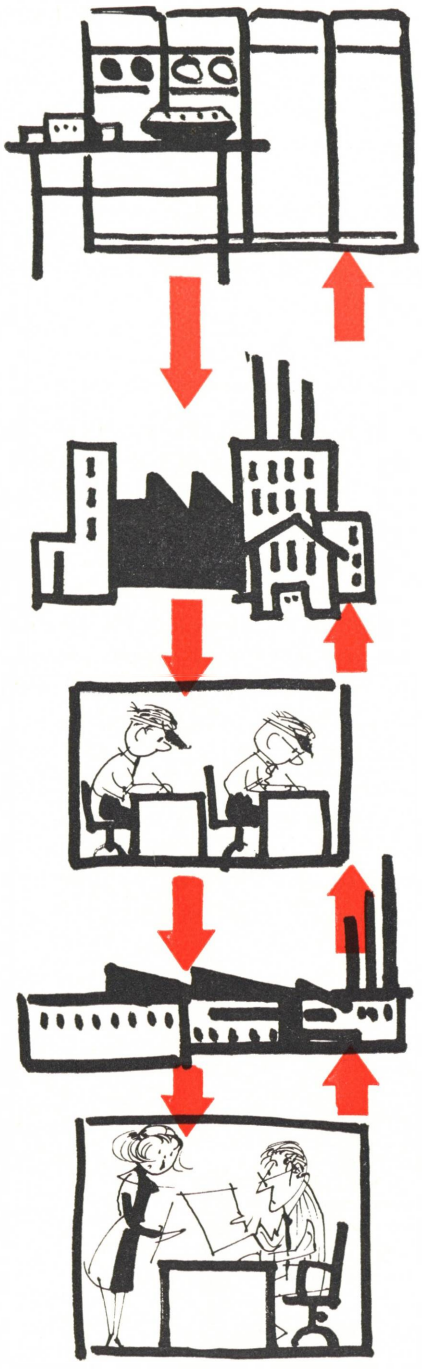
The accountant's involvement

Although most observers twenty-five years ago could not have foretold the extent of the accountant's present involvement with these new developments, hindsight makes the trend appear quite logical.

We have already made clear that the major ingredients in quantitative analytical models and management information systems are accounting data. Electronic computers also involve the accounting operation in a major way. Business machines, which were the ancestors of the electronic computers, were used most extensively in ac-



Linear programing techniques may evaluate shipment to and storage costs at all a company's warehouses to find the best overall distribution pattern.



Computers, used in a well designed information flow, help improve the management information system.

counting operations such as billing, sales statistics, inventories, payrolls, accounting and financial reports, and similar applications. Although application of the machines spread to other areas of the business such as engineering and research as they became more powerful, many of them are still operated by the accounting department as a service to all departments of the business.

All these circumstances have combined to involve the accountant in the acquisition of management services capabilities. Although some have not been equal to the challenge, most accountants' educational background and business orientation have enabled them to learn to use these advanced techniques. The CPA has kept pace with the corporate accountant in this advance in professional competence.

In the eyes of many businessmen, the CPA's organization and method of operation make him a preferred source of management services. There are two basic reasons:

1. The CPA's audit and accounting practice bring him into close contact with problem areas.
2. He is already dealing directly with the "consumer" of many of these new services.

Contact with problems

The CPA has an unusually fine opportunity to observe weaknesses and inefficiencies in systems and procedures during the course of his ordinary audit functions. This is not a matter of expanding on the scope of work that would be involved in an audit but rather of bringing to bear added competence to evaluate the control and business aspects of what the CPA observes.

For example, it is a well established practice for the auditor to review the procedures and systems of control in financial and related areas in order to form a judgment as to their inherent strengths and weaknesses. Based on this judgment, the auditor adopts a more expansive or restrictive scope of sampling and checking to arrive at a conclusion as to the fairness of the financial statements being certified. Results observed are discussed with the client and suggestions for remedy offered. Very often the process stops here, and the client benefits by taking the suggested remedial steps himself. In other cases, the management services personnel of the CPA firm may be called upon to assist.

Furthermore, the CPA spends a significant amount of time in a review of inventories in the normal audit of an industrial company. Required investigations of conditions causing inventory shortages, erroneous costing, and unbalanced quantities may often uncover the need for major or complete revisions in cost standards, inventory records, and production and inventory control systems.

Many examples such as these demonstrate the important management services benefit clients may obtain as a by-product of an audit. As a result, many companies consider it desirable to have one firm handle their audit, tax, and management services affairs. In turn, the CPA firms also have recognized the obvious benefits of broad and integrated services, and more of them are working in that direction.

The CPA is regularly in touch with the top echelon of his clients' financial, manufacturing, sales, and executive management. This is where the strains of ineffective systems are felt and decisions are made to seek outside help.

Contact with user

In our own recent experience we have heard two company presidents, shortly after assuming their new duties, complain about the reporting systems of their companies. In one case insufficient data were provided for management to understand and operate the business effectively. In the other case too much data were provided in unrelated, voluminous, and sometimes inconsistent form. In both cases, satisfactory results were

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achieved as a result of systems engagements directed at improving the form, content, and timeliness of management reporting.

How many times does the accountant hear questions like these?

From the financial vice president — "What do you fellows know about electronic computers? We have been hearing a lot about the ability of such equipment to provide better and quicker management information and possibly clerical cost savings. How do we go about determining whether they could be applied to our order processing and billing operation?"

From the manufacturing vice president—"How can we achieve better control over our inventories? Our investment in inventories is increasing at the same time our order backlog is increasing because we are missing delivery schedules for the lack of certain critical components. Our production planning and scheduling and inventory records and paperwork should be reviewed critically and revised where necessary."

From the sales vice president—"If I could cut down on the paperwork done by my people, I could spend more of my budget on selling effort, which is what we must do to maintain or improve our market position. How can we streamline our office operation?"

From executive management—"It looks as if the demand for our products for the next five years will be somewhat less than our plant capacity. We appear to be faced with a decision on how to reallocate production among our plants and perhaps which to close down in order to achieve lowest total costs. I understand that solutions to problems like this have been aided by operations research techniques. Can you help us?"

The CPA who has acquired management services competence is able to rise to the challenge and accept the opportunity to render a broader, more constructive service to modern business—and the businessman has been impressed with the response.

The CPA is enjoying a growing share of the management services consulting business as a result of his involvement with many of the developments that are making better management planning and control possible. The broadening of his role has come easily and logically because of the business environment in which he has provided audit and tax services and his willingness to acquire the necessary competence.

However, there are some CPAs who have not moved into the mainstream of this activity, in spite of the fact that they are natural heirs to a large new class of developing practice. Perhaps they should read what a distinguished member of their profession said on this subject:

"The auditor should keep fully informed on the latest devices, mechanical and other kinds, for saving labor or rendering it more efficient; he should understand and be prepared to explain the relation of one department of a business to another and the advantages of coordination; he should study cost systems and be ready to install any required accounting system; he should acquire and follow up a knowledge of the means of imparting information by means of charts and other visual methods.

"It might be urged that an auditor cannot hope to cover more than a small part of the field of auditing within a considerable period of practice, and that to expect him to add the work of a system specialist is unreasonable. The answer to this is that no one can be a good auditor without picking up all of the rudiments of systematizing, and that in any event system is a matter of evolution.

"Ready-made systems have been popular, but never successful. No system will work out well unless a good man studies the concern and becomes acquainted with its personnel before he starts, and then 'lives with the job' until its completion. The auditor may not be able to handle many such engagements, but he should not allow the so-called system experts to bluff him out of the remunerative work. He is probably better qualified to perform it than anyone else."

That quotation is taken from the 1916 edition of Montgomery's *Auditing Theory and Practice,* published some fifty years ago.