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Recognizing Management Services Opportunities

Jordan L. Golding

Many a CPA firm, well qualified to perform management services, simply does not recognize needs revealed in its performance of audit and tax services. It thus handicaps both itself and its clients—

RECOGNIZING MANAGEMENT SERVICES OPPORTUNITIES

by Jordan L. Golding
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THE DECEMBER, 1968, issue of *The Kentucky Accountant* referred to management services as "that area of practice where the horizons are unlimited." Certainly, management consulting is one of the fastest growing phases of our profession and, indeed, a very profitable part of our practice. While the area of management consulting offers unlimited opportunities for the CPAs that are engaged in such practice, it also offers severe penalties for those who choose to ignore what has now become an integral part of our professional practice.

We have often been asked to comment on how one goes about recognizing management services opportunities and, yet, we feel that this particular point can be answered very simply: We are convinced that the recognition of such opportunities is identical with the recognition and understanding of clients' needs.

It is doubtful that any audit-oriented accountant believes that auditing is a mechanical function. On the contrary, auditing has become more and more sophisticated and more challenging as the complexity of business operations increases. Thus, the CPA on an engagement has to be ever alert for changing circumstances in his environment.

Similarly, the practice of taxation is hardly confined to the mere mechanical processing of government forms, but rather is totally integrated with the ability to comprehend and make recommendations with respect to client tax planning and avoiding of serious tax pitfalls.

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As long as the profession is so heavily involved in clients' affairs via the audit and tax aspects of our practice, it is almost impossible not to be aware of other operational problems that exist within the client's organization. These problems may consist of the need for a more modern cost accounting system, improved pricing policies, inventory controls, systems work, or the consideration of the feasibility of some form of modern data processing within the organization.

The client may also have need for other types of special studies: in connection with expansion or contraction of the business, acquisitions or mergers, going public, and a host of other more esoteric types of situations where the client may require outside professional advisory services.

There are those in the profession who say that this may very well be true, but really it is only applicable to the larger firms. Nothing could be farther from the truth. The need for consulting services affects the entire profession in both small and large firms, and including the individual practitioners. The needs have been equally intense with both small and large clients. The only variable seems to be the degree of complexity.

The day has long passed when the small client looked upon his auditor as a pencil pusher who merely informed him as to how well his business had operated during the recent year; and the large publicly held clients no longer look upon their auditors as merely members of that organization which comes in once a year, as a necessary evil, to pass an opinion on the financial statements for the benefit of stockholders and other third parties.

The point was made very well by Leonard Savoie, executive vice president of the AICPA, in the December, 1968, issue of *The CPA* in his article entitled "Marketing Myopia." In it Mr. Savoie stated:

> An accountant who thinks merely in terms of providing the company's management the same old audit based on the same old loosely defined practices is product-oriented. Unfortunately, his product is *obsolete* and old rules are not good enough to satisfy the public.

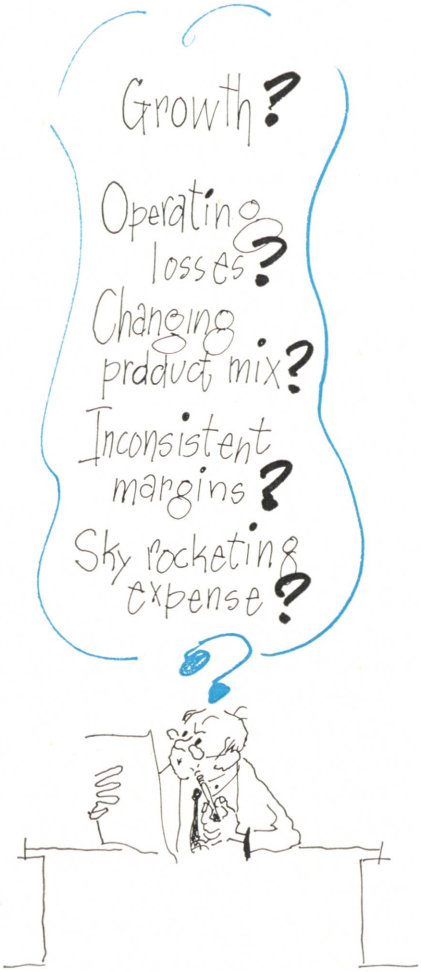
The small firms that ignore this marketing problem within the profession will find that if they do not keep pace with the growth of their clients and their clients' ever-changing needs then their clients will seek the full range of services that other firms provide. For larger firms, the same problems exist and are compounded by the fact that if they do not recognize their clients' needs, or are not in a position to provide services to handle the clients' problems, then the opportunities will slip by the boards; they may find that if not displaced by another accounting firm, then certainly they will have outside consulting organizations involved with their clients' problems.

But how does a CPA go about recognizing opportunities in management services work with his clients?

We have audit staffs who are on the client's premises, on a monthly, quarterly, semi-annual, or annual basis. Certainly, these men should be bringing back comments with regard to the adequacy or inadequacy of internal control, or other conditions that exist within the client's organization that might need improvement. The partners and managers involved in these audits are, or should be, in reasonably frequent contact with the client so that they are aware of the fact that certain conditions exist that should be of concern to the management of the client's company. Even without communicating with client management, the review of working papers may exhibit problems created by growth, operating losses, changing product mix, inconsistent margins, skyrocketing expenses, that bear out the fact that further investigation might be prudent on the part of the CPA firm. Losses, stagnation, and growth are all indicators that maybe something more can be done for the client to improve his operation.

We should like to be specific and cite some of the situations or op-

The CPA who does not keep pace with the growth—and the needs—of his clients will soon find those clients seeking other advisors.



The review of working papers can reveal problems caused by growth, operating losses—a variety of factors.

portunities that can be easily recognized by many CPAs. The list certainly is a sampling and doesn't attempt to be comprehensive or all inclusive. By the same token, we do not mean to imply that all accountants are capable of or possessed with capabilities within their firm of administering the following types of management services engagements. Nevertheless, we think you will find them a representative sampling of management services opportunities.

A. *INTERNAL CONTROL REVIEW*

A key element in any audit engagement is the internal control review, which very often reveals shortcomings in the internal control system of the client. Many of the deficiencies that auditors uncover are elementary in nature and can be remedied by discussion with the corporation management.

On the other hand, other situations are more complex and lead to the type of management services engagements that will be described later on.

B. *INFORMATION SYSTEMS*

Does the current reporting system provide management with adequate information on which it may base its business decisions? For example, in reviewing the annual results of the client do the following shortcomings appear?

1. Is the chart of accounts adequate to provide sufficient breakdowns in various sales or expense classifications to make the reporting system meaningful?
2. Does the client have adequate information about product lines? Very often in the growth of a company, product mix changes, and accordingly conglomerative information sometimes hides serious shortcomings because there is not adequate information shown by important sub-categories.
3. Likewise, is there adequate costing or gross profit by product lines? All too often, such gross profit analysis by major product classifications is not available and the business finds itself in a deteriorating position before it is even aware of the fact that it has a problem. Proper product costing information will flag such serious situations before there is serious erosion of profits.
4. Does the present information system provide for adequate expense and overhead classifications by realistic cost center?
5. Does the company have budgetary control over its expense classifications, or does it merely compare this year's expenses with last year's without setting a goal for the current or forthcoming year?
6. Has the flow of paperwork so increased that data processing of some sort is now an item that should seriously be considered by management? If so, there is an opportunity here for a feasibility study.

On the other hand, if the company already has a data processing system, is it properly being utilized and is the internal control adequate? All too often companies have converted to data processing, but are not getting the true value from the computer system. Experience has shown that many clients have invested in expensive data processing equipment, only to use such equipment as high-speed print-

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ing presses or adding machines.

C. RETAILING

If the client is in the retail business many special problems arise that should be reviewed each and every year. For example:

1. *Cash*
   a. Is the control over cash adequate? Should more sophisticated cash registers that are capable of simultaneously accumulating management information be considered?
2. *Inventory Control*
   a. Does the company have an inventory control system? If so, does it control the inventory or does it merely keep records without, in fact, controlling inventory?
   b. How does the stock turn compare with industry standards?
   c. Are there automatic reorder points on the stock levels if an inventory control system is in effect?
   d. What kind of controls and management information does the business have over markdowns?
3. *Delivery*
   a. Does the store have an adequate delivery system that takes into account the geographic distribution of its delivery routes so as to minimize overtime and, at the same time, to accommodate customers?

D. WAREHOUSE DISTRIBUTION

Many of the considerations in this area also apply to those multi-unit retail operations that run one or more warehouses.

1. *Physical Layout*
   a. Are the racking and actual physical storage of the merchandise accomplished so that damaged merchandise is minimized?
   b. Does the company have a locator system and a picking sequence system so that material handling of the merchandise is minimized, in an effort to reduce labor costs to a minimum?
   c. Does the company have cost information for the order filling process?
   d. Is there adequate control over delivery costs? Are the loading of the delivery trucks and routing done on an efficient basis?

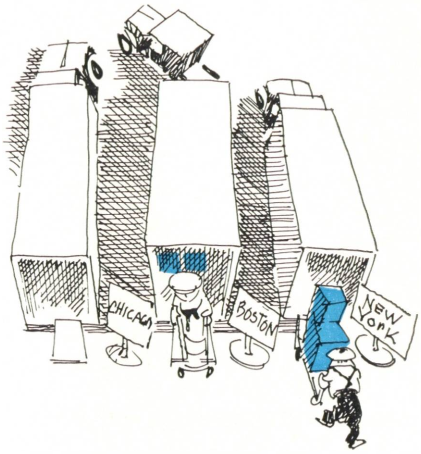
E. MANUFACTURING

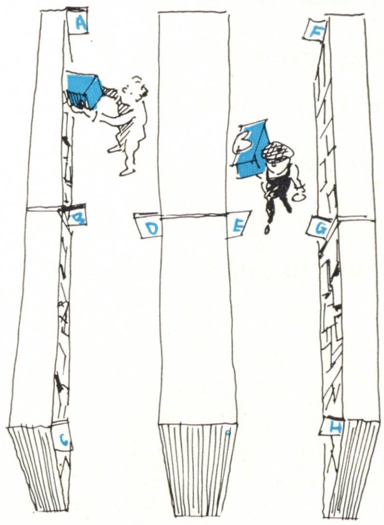
1. *Cost Controls*
   a. Does the company have adequate information as to its fixed and variable costs with respect to manufacturing activities?
   b. Are the cost centers realistic? Do they provide adequate information as to cost of producing the product?
2. *Inventory Levels*
   a. Is there adequate control over:
      1. Raw materials
      2. Work in process
      3. Finished goods inventory levels?

F. PERSONNEL

Very often a company exists without adequate regard to people who are in the company and are contributing to its success, or failure.

1. Is there a high rate of turnover that is symptomatic of other problems with respect to personnel policies?
2. Have compensation levels gone out of control? For example, often salesmen's commission rates are set at an early stage and later on turn out to be unrealistic with respect to the competitive situation within an industry. This can also be true with respect to inside personnel.
3. Is there a lack of appreciation of the fringe benefits or are





In warehouse distribution problems obvious factors to check are the actual physical storage of the merchandise and the efficiency of loading and routing of delivery trucks.

the fringe benefits in fact inadequate?

4. Are there adequate employee records?

5. Can the client honestly say that he has a loyal group of employees and, if not, what is this symptomatic of?

6. Has the company been able to satisfactorily recruit the kind of personnel it requires?

7. The Incentive System: Are there proper incentives, both in present compensation and deferred compensation?

G. PROFIT PLAN

Does the company have a long-range plan for growth, one that has been reduced to written form and that possibly spells out goals for the next five to ten years?

Business is in a constant state of change. Companies move ahead, companies fall behind, and some just stagnate and hold their own position. In any event, whether it be in a state of growth, decline, or stagnation, the requirements of the business are also changing. Even stagnation itself is a problem: If the business cannot move forward, it is effectively falling behind its competitors.

In any event, irrespective of the direction of the business, it offers opportunities for the CPA to assist the client in adjusting the company to the business climate so that he can conduct its affairs in a more profitable manner.

We should always be on guard, however, to make sure that we are not solving symptoms but rather that we are getting to the heart of the basic problem. All too often, what appears to be a problem may be a symptom of something larger and it is this larger area which should be attacked first.

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We do not mean to suggest that we offer management services work where none is warranted; however, the point is that we must ever be alert to the fact that the client may indeed need help without knowing we are in a position to serve him on that particular basis, or more important, he may recognize the need for assistance but not be aware of the fact that the CPA firm is in a position to provide such corrective services.

The communications gap

Often I have found myself at a social gathering on a Saturday evening and a nonclient approaches me and asks for some off-the-cuff advice with respect to data processing, budgetary, or other type work. In many instances, I am aware of who the accountant is for the particular account, and I generally reply by asking: "Haven't you spoken to your own CPA about this matter?" The shocking response has all too often been that either his accountant is too busy to be involved, or else that the client is unaware that the accountant provides such services. With regard to the latter point, I have known on many of these occasions that the accountant in fact did provide the services and provided them on a very competent basis. It would certainly indicate that the CPA in question either did not recognize the client's need, or if he did recognize it, he never communicated his services to the company in question.

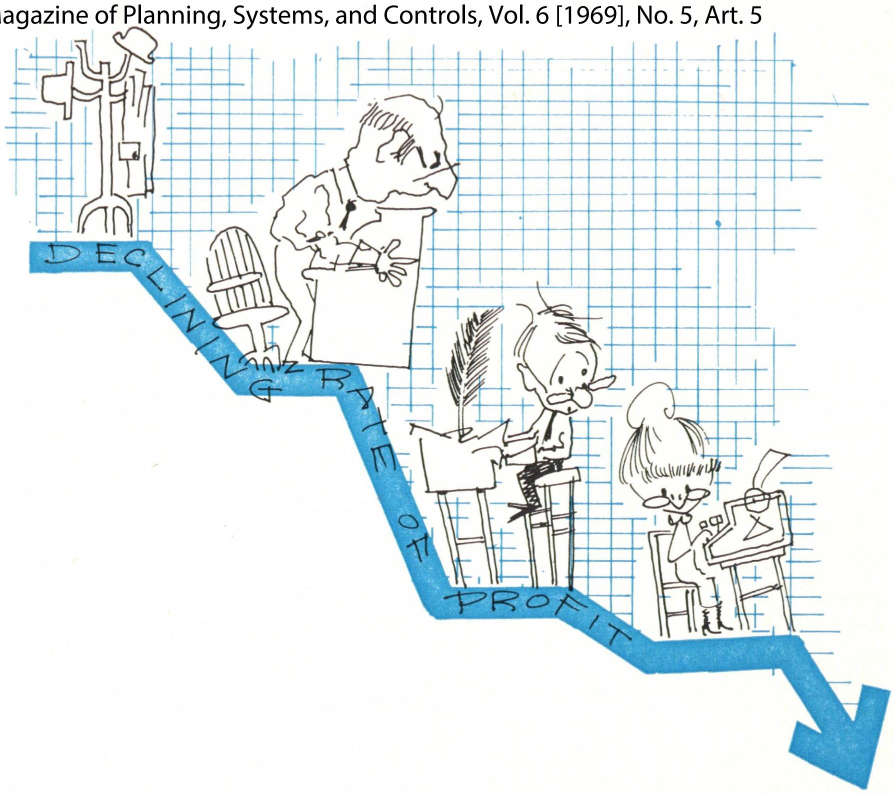
In such instances, the CPA is fumbling the ball away to the opposition. If we are supposed to be professional men who are competent in advising our clients on the successful administration of their own affairs, then certainly we should be the first to keep our own practices on the most businesslike basis. Muffing opportunities is not one of those qualifications.

Let us move on to another problem of our time. On almost any day of any week the financial pages of our newspapers carry the news of all types of corporate mergers and acquisitions. Some of these involve two giant corporations, both offering stock that is publicly traded. On the other hand, often a large publicly held company acquires a local, closely held firm, maybe one of your clients. Why are these family businesses being gobbled up?

In some cases there are good solid business reasons for the so-called "merging-out" of a family business. On the other hand, there are many instances where the local business has had many years of profitable operation but somehow has either lost its purpose, sense of direction, or is otherwise floundering in today's more competitive economy.

Maybe this segment of the acquisition fever of today is a symptom of lost opportunities for CPA firms. Perhaps if the accounting firms that are losing these clients were recognizing opportunities for giving the business new vitality, either via long-range financial planning, better cost control, pricing and marketing analysis, organizational studies, planning for succession of management, or even making special studies as to the feasibility of going public, maybe these clients would be doing the acquiring rather than being acquired.

In all too many cases, the accountant, who is the closest outsider to the management, is passing up golden opportunities through default. More important, he is losing a client by his failure to perform needed services.



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Auditors' key position

General George S. Doriot, president of American Research and Development Corp., has said: "The businessman stands naked before his accountant." Nothing could be more true, and, because of this close relationship, the accountant should be able to spot almost every opportunity that management itself fails to recognize.

The training of audit staff to recognize the opportunities for improving the client's operations not only benefits the accounting firm from the standpoint of creating management services engagements, but also the client because the latter has enhanced his own operation; furthermore, it also stimulates the staff men to widen their horizons of vision. To the extent that the staff accountant is capable of such an approach to a broader scope of accounting, then his job becomes more interesting and more rewarding, and, accordingly, he becomes more valuable to the firm.

Once having defined the problem and recognized the need, the question then becomes one of communicating what you have found to the client. Obviously, this can be done verbally; however, a better approach may be the so-called management letter or formal presentation that many firms now use in calling the client's attention to shortcomings that may exist in his accounting or related needs. This is usually done at the completion of an audit, when the partner, manager, and senior on the job put their heads together and summarize the management results of the audit that highlight shortcomings in either internal control or the related accounting problems. The advantage of the written management letter is that it has a lasting effect with the client. If the recommendations are communicated verbally, often they are forgotten in the turmoil of day-to-day routine problems. The suggestions and deficiencies that are set forth in writing permit you to leave behind on the client's premises your thoughts and recommendations regarding the problems that you have uncovered, and also the recommendations as to how you would suggest the company proceed to remedy the situation.

It would therefore seem that in summary we have a two-part problem. One is the recognition of client needs, and secondly the communication with the client.

Consulting should be a separate formal engagement for which the practitioner should be paid separately. If consulting is truly an integral part of our profession, then it should be practiced on a professional basis. That is, it is not merely off-the-cuff advice based on failure to do adequate fact-finding prior to making recommendations or implementation.

For example, in auditing our clients we develop our working papers, we gather our facts, we present a statement, with or without qualifications. But these financial statements are backed up by working papers that document how we have arrived at our conclusions. By the same token, each tax planning situation has its idiosyncrasies. In estate planning we gather details regarding total assets, nature of the assets, number of potential beneficiaries, and the basic objective of the client for whom we are doing the planning.

Similarly, in consulting we must gather our facts, make our analysis, and come up with our recommendations and, possibly, the subsequent implementation.

But also, because consulting engagements can often be quite time-consuming, the client should have an understanding as to how much time will be involved on our part and what his costs will be. Thus, we have the proposal letter, which really is a letter of understanding between the CPA and the client with respect to the nature of the engagement, the degree of responsibility to be assumed by the CPA, and the approximate cost of the job. All these are spelled out in the AICPA booklet entitled "Guidelines for the Management of a Management Advisory Engagement."

Granted, many CPAs, especially those in smaller practices, are quite familiar with their clients' affairs and are in a position to give reasonably sound advice in a limited number of circumstances without this involved formal process. Nevertheless, the more important problems such as the installation of a cost system, an organizational study, budgetary and forecasting work, and data processing feasibility studies cannot be done off the top of your head, but should be structured on a formal basis. This is the professional approach!

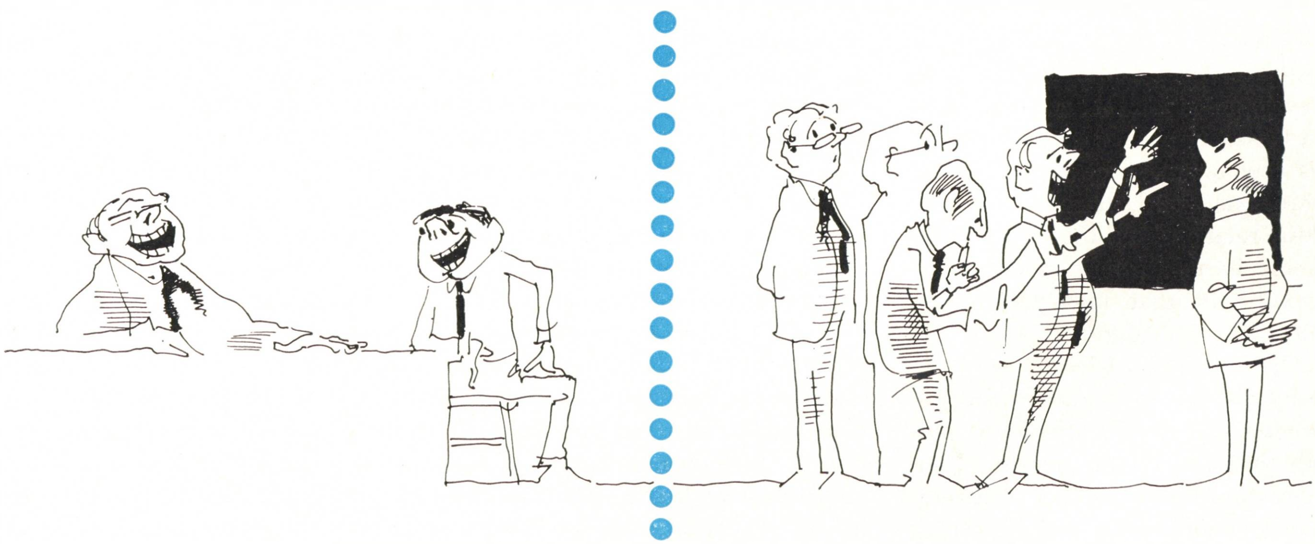
Analogous situations

When I have talked on this subject before professional groups, I have often been confronted, in the question period, with a remark such as:

"What you say is fine, but I run a very small practice and my client pays me $200.00 a month, for which he expects a monthly estimated profit and loss statement, an annual financial report, together with his corporation and personal tax returns. I cannot possibly be paid for the type of work that you describe over and above my fee."

This occurs in both small and large cities. Smaller practitioners who have smaller clients are often on a monthly or annual retainer. The answer, however, lies not in the area of management consulting, but rather in the management of an accounting practice. Does this small practitioner who receives a regular retainer of $200.00 a month mean to imply that he will undertake a major litigation on a tax question with the Internal Revenue Service without any additional charge to his client? If so, then maybe we are talking about practice management and nothing else. If he is a professional, and if he is capable of representing the client before the Appellate Division of the Internal Revenue Service, then he should be paid over and above his monthly retainer for such specialized services. The same holds true in consulting.

The hardest thing in the world seems to be breaking away from bad habits. The flat retainer without any adjustment for extra work is a professional bad habit. It is easy to stand up and give many reasons why that particular client will not pay more for his services,



The consultant can communicate his finding and recommendation to the client verbally of course, but a much better and more professional approach is the management letter or formal presentation.

but such a comment always reminds us of a remark in a book review which appeared in *The New York Times* in June of 1968. The reviewer, discussing a book on the fall of Singapore, referred to one of the generals involved in the defense of that installation. The reviewer in turn quoted Ian Morrison of *The London Sunday Times* who described the gentleman as follows:

"Having a mind that saw the difficulties of any scheme before he saw the possibilities and so refused to prepare defenses along the northern coast as the Japanese advanced because this would affect internal morale."

Certainly, it is not easy to break old habits, but management consulting offers unlimited horizons and the opportunity also to restructure CPA practices so that you can capture the opportunity to perform greater services to your clients, to grow in size, to offer greater opportunities to your staff, and to generate more profits. Like our clients, we must never forget we are in a business to make a profit.

Building a consulting practice

There may be some who say, "Fine, I agree with everything you have said, but really, how do I get started?"

For one thing you may have some bright juniors or seniors on your staff who have shown an inclination, and a scope of vision, that indicate that they might make excellent consultants with a little additional training. On the other hand, there may be a total void of such talent in your organization and you may have to hire from the outside. In any event, the American Institute is cognizant of the problem and has already developed professional development courses in the area of starting a management services practice.

Often, specialized help in developing competence in computers and other technical areas is available from former employees of computer manufacturers. In any event, there is a supply of talent both within and without your organization. It should be utilized.

There is another benefit to be had from structuring a formal management consulting department within your organization. Not only do you offer a wider range of services to your clients, help your clients grow, and improve the profitability of your own practice, but you may also enhance the image of your firm to the point where you make it a more attractive organization from the standpoint of recruiting talent, not only from the consulting standpoint but also for the firm as a whole, including the auditing and taxation sections.

Recruiting aid

The young men out of college are looking for opportunity. And opportunities are greater when the firm is growing faster. The bright young graduate in an accounting college is more likely to be attracted to a fast-moving progressive firm than he is to one that is confined strictly to an audit practice that may be stagnant or may be losing clients because of its lack of total services.

In conclusion, the development of a sound consulting practice offers exciting opportunities to the growth-oriented CPA firm. To ignore the challenge may result in loss of clients, or, at best, the failure to be in a position to play an integral part in assisting clients to improve their own profitability.

Recently we had the privilege of attending the annual meeting of the National Retail Merchants Association in New York. At that time the NRMA Gold Medal Award was presented to Mr. William M. Batten, chairman of the board of the J. C. Penney Company.

We would like to close by quoting a few of the words spoken by Mr. Batten in accepting the award:

"To ignore change is the second fastest way to suicide . . . to fight change is the fastest way."

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