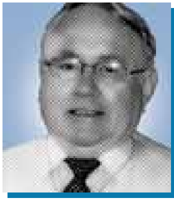

ASHLEY BURROWES FCA AND
ROBERT JINKENS IN THE US

Healthy scepticism

Scepticism is necessary for an objective, independent audit.

The Enron collapse in the USA 12 years ago brought with it a lot of soul searching by the US Congress, the US Securities and Exchange Commission and the American Institute of CPAs about the independence of auditors from the clients they audit.

Eleven years after the Public Company Accounting Reform and Investor Protection Act became law on 30 July, 2002, the issue is "hot" again, but this time the independence issue seems to be more widespread than before, with the EU, UK and USA regulators calling for independence, objectivity and scepticism on the part of auditors.

Regulators are saying that as audit firms expand their fee base at an unabated pace beyond traditional auditing, serious incursions into the "independence veil" are evident. The regulators maintain the key audit ingredient of scepticism cannot be evident as auditors provide more and more management consulting services. The professional auditing standards in New Zealand, USA, Holland, UK and the EC all recognise scepticism as being essential for an objective, "independent" audit.

The influence of US regulators, SEC and the Public Company Accounting Oversight Board (the US auditing overseer) will spill over offshore as increasing numbers of companies from foreign countries seek listing on one of the US stock exchanges.

The five year plan for the PCAOB "… will also continue its inspection work globally by boosting its Global Network Firm inspections…"[1]

An upshot of the Hewlett-Packard's problematic purchase of British software company Autonomy has resulted in awkward questions being put to all of the Big 4 accounting firms as HP face a massive write down on the investment. As *The Economist* identified, there are more lenient rules on management advisory services by audit firms in the UK than in the USA[2].

Notwithstanding the above, the American Institute of CPAs (AICPA) recognises that accountants around the world are increasing earnings from management advisory services and have suggested some practice metrics for review.

METRICS FOR PRACTICE IMPROVEMENT[3]

The AICPA has recently addressed the efficiency of public practices and come up with a number of suggestions. These suggested practice management techniques could measure a firm's reach with clients and provide insight into how well processes already in place are helping to identify opportunities with clients.

1. Lifetime value of a client

The sum of all revenues generated from the firm's service offerings over the lifetime of the client. Most accounting firms want to know this metric and how it changes from year to year for the biggest clients. It is good to review how long these "A" clients have been with the firm and to monitor whether new service offerings have been introduced to those clients.

2. Cost of client acquisition

The US AICPA estimates it costs 11 times more to bring in a new client than to keep an existing one, so studying this metric is a good reminder of those differences. Knowing this metric can also help your firm evaluate how effective its efforts are to reach the target audience.

3. Client retention rate

Each firm can't be everything to every client or potential client, so it is important to know which service offerings are most successful. Where is the firm keeping clients, and what patterns can help refine the approach to client services? Evaluating the retention rate for clients at one-, three-, five- and ten-year intervals can provide insight into how to keep the relationship on solid ground.

4. Average number of services per client

Compare this alongside retention rates. As your practice is more closely entwined with

a client, it will be more attuned to their needs and can address a greater spectrum of clients' needs. That can increase the retention rate exponentially.

5. Average number of top-client "touches" per month

Knowing this helps your firm ensure its most important clients are constantly being contacted and that there are many avenues for identifying those clients' needs. Looking at this metric by partner and by industry can be used to improve internal communication so that partners excelling in certain industries can teach others.

6. Average client response time

This is the first step in developing a firm that is truly responsive to client needs.

7. Number of cross-selling opportunities vs those won

A huge discrepancy between these two numbers can identify a need to develop training so staff can identify where client needs can be better served. Looking at this metric for various partners or industry practices can identify who at your firm is really successful at cross-selling, fostering a team-oriented approach.

8. RFP win percentage, other proposal win percentage and pipeline win percentage (or pipeline conversion)

As your firm looks to bring in new clients, what avenues have been the most successful? If RFP win percentage is low, what can you do to make your firms' messaging more effective with the target audience? These metrics also help your firm refine messaging and offerings related to specific services. No firm can be everything to everyone.

9. Average number of professional development hours per firm member (monthly and annually)

When a prospective client meets with an accounting firm, they assume the technical skill set is there. It is the soft skills training and development that firm members have received that will set the firm apart, will make client relationships more meaningful and will help with opportunity development. When senior employees leave, they often express it is because they don't have the resources or guidance to grow their career. Where we see firms having more success retaining their most important asset (people), is where "A" firms place more value and emphasis on the cultural development of its people.

Regulators are saying that as audit firms expand their fee base at an unabated pace beyond traditional auditing, serious incursions into the "independence veil" are evident

10. Utilisation rate and realisation rate (by service offering)

These are highly quantitative measures, but they are important to track as they provide information on how profitable the firm's services are. They also can be used to help refine offerings.

11. Staff-to-partner ratio

Partners should be most focused on their core competencies, but that means having the proper team in place for support. What that proper ratio is depends on the size of the firm. Chicago-based consulting company The Rosenberg Associates recommends a range from a 2.5-to-1 ratio for CPA firms with revenue below $2 million, to a 7.9–to-1 ratio for CPA firms with revenues over $20 million.

12. Revenue growth per year (actual vs expected)

This should be examined by service offering/line, by partner and by industry, and ideally, the actual would be at or higher than the expected/budgeted. If not, your firm can evaluate why – which members may be falling short and how your firm can better equip those teams and individuals to hit goals. This is also an opportunity to evaluate whether targets are meaningful or whether goals should be adjusted.

1 PCAOB: Not Just Mr. Bad Guy at www3.cfo.com Auditing | November 28, 2012 | CFO.com | US
2 The Big Four auditors: Accountable, 8 December 2012, pp74-75.
3 Adapted from AICPA Insights: blog.aicpa.org/2013/01/the-defining-dozen-12-metrics-cpa-firms-should-track.html#sthash.G3GxiFR5.Ad8myUTK.dpuf

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