Firms should split to restore faith

The major accounting firms may need to consider whether they should split up their practices in order to make it easier to monitor the quality of audits and partner performance, according to Art Wyatt, a former senior partner at Andersen.

Wyatt spoke at the recent American Accounting Association conference held in Hawaii about the profession's apparent lack of comprehension of why people lost faith in accounting firms.

He said a part of the problem was the consulting mentality that was grafted into the culture of accounting practices when systems installation and other types of consulting work became the focus of accounting firms.

Wyatt argues that the firms became somewhat obsessed with the cross-selling of consulting services and similar phenomena. He notes that those partners with technical skills found themselves having a lower prominence.

"The issue was not how the delivery of a particular consulting service might affect the auditors' judgment. The issue was not how the existence of consulting fees that were even greater than the annual audit fees might affect the auditors' judgment," Wyatt notes.

"The issue was how the increasing infusion of personnel not conversant with, or even appreciative of, the vital importance of delivering quality accounting and audit service affected the internal firm culture, its top level decision and the behavior patterns of impressionable staff personnel."

Younger staff, Wyatt observes, observed the behavior of senior partners within the accounting practices and sought to emulate those that were climbing up the ladder within the practice.

"No one rang a bell in a firm and announced, 'Quality professionalism is out!' On the other hand, keeping the client happy and doing what was necessary to retain the client achieved a prominence that did not exist prior to the advent of the successful consulting arms within the firms," he says.

Wyatt declares that clients were more easily able to persuade engagement partners that the client's view of a transaction was both correct and desirable, which also led to a notion that the audit firm could fix the problem the following year.

"Healthy scepticism was replaced by concurrence. The audit framework was undermined and the result was what we have recently seen in massive bankruptcies, corporate restructurings, and ongoing litigation," he states.

The environment that focused heavily on developing the consulting business meant that quality control took a back seat in some circumstances. Wyatt questions whether the firms that are left at the top end of the profession should contemplate splitting up in order to make it easier to monitor quality and partner performance.

He suggests the Big Four may have become too big. This growth has probably made it tougher to maintain the requisite degree of control on partners and staff.

“The top leadership in the firms also needs to consider whether the four largest firms are really effectively unmanageable. In smaller accounting firms – or when the current four large firms were smaller – a key partner is able to monitor partner performance and be able to assess the strengths and weaknesses of individual partners,” Wyatt explains.

“As the large firms have grown to their current size, the challenge to have such effective monitoring is substantial. Maybe some consideration should be given to whether a split up of a big firm would enhance the firm’s quality control and permit more effective delivery of quality service.

“While such a thought will no doubt be draconian to some, one only has to consider what might be the end result if one of the current four firms meets the same fate as Andersen. Firm break-ups might then be at the mercy of legislative of regulatory interventions – an even more draconian thought. The bottom line, however, is, are the large firms able to manage their practices effectively to assure top quality service to their clients and the public?”

Wyatt contends the profession had failed miserably to maintain or deserve the public’s trust because greed gradually climbed from the back seat, shoved professionalism aside and slipped into the driver’s seat.

“In essence, the cultures of the firms had gradually changed from a central emphasis on delivering professional services in a professional manner to an emphasis on growing revenues and profitability,” he states.

“The gradual change resulted in the firm culture being drastically altered over the forty years leading up to the end of the century.”

A primary reason for the existence of accountants was to provide credibility to the financial statements of corporations so that members of the public could have confidence in the numbers produced by the entity.

“The credibility added to a client’s financial statements by the clean audit opinion was the central reason for a CPA firm’s existence. This focus gave way to a focus on an ever expanding range of services offered to a client pool fighting to achieve the short-term earnings per share growth expected of them in the marketplace.”

This article was supplied by Tom Ravlic. Tom Ravlic is a financial journalist who has spent the past seven years covering the accounting profession, accounting and audit standard setting and corporate governance. His work has appeared in various publications including *Business Review Weekly*, *Personal Investment* (now *Personal Investor*), *The Age*, *CFO Magazine*, the *Australian CPA*, the *Company Director Journal* and the newsletters of the internationally renowned Lafferty Group. In addition to his freelance commitment to a wide range of publications, Tom has recently accepted an appointment to be editor of *Chartac Accountancy News*, published by Melbourne-based publisher Crown Content.