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How CFOs Can Contain Rising Audit Costs

High audit costs could start to force smaller businesses to sacrifice fiscal health for compliance. Specialized CPA firms may offer lower-cost services than major accounting firms, says an executive at one such CPA firm.

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VIEWPOINT/AUDIT

Someday, the accounting industry will look back over the early 2000s and pinpoint the moment when compliance and accounting requirements began to hold companies back from fulfilling their potential. A chain of events triggered by the implementation of the Sarbanes-Oxley Act led first to a panic, then to a scramble and finally to a money magnet so powerful it is changing the course of companies, especially small and mid-sized enterprises.

As business leaders determine the best internal paths to take, the professional services world is also adapting to provide relief. The CPA landscape is dotted with emerging, specialized firms that aim to use their agility and more flexible fee structures to act as non-audit advisors, to complement auditors. The potential exists to leverage the expertise of these firms to balance accounting costs while maintaining high levels of quality. In the end, engaging the right CPA firm as the non-audit advisor can give companies greater independence to seek out advantages that may be difficult to attain with a Big Four auditor.

Audit fees were predicted to decline as the initial preparations for Sarbanes-Oxley compliance were tackled. The opposite has been true, however — a fact highlighted by the fourth annual Foley & Lardner study on Sarbanes-Oxley implications (*The Cost of Being Public in the Era of Sarbanes-Oxley,* by Foley & Lardner LLP, June 2006). The report notes that while the overall cost of compliance is indeed beginning a slow descent, audit fees are doing just the opposite. According to the study, fees rose by 22 percent for S&P small-cap companies in 2005, 6 percent for S&P mid-cap companies and 4 percent for S&P 500 companies.

Even as the Public Company Accounting Oversight Board (PCAOB)

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Companies can pursue two distinct but equally important lines of attack to take back control of the bottom line: easing costs associated with non-audit CPA advisory services and mining governance initiatives for extended return on investment (ROI) that will pay dividends down the road.

investigates ways to temper the situation through Sarbanes-Oxley rules changes, it is becoming clear that audit fees have taken on a life beyond Sarbanes-Oxley and are significantly impacting non-accelerated filers. High costs are starting to force businesses to sacrifice fiscal health at the expense of compliance.

Business leaders should snap to attention with the startling realization that the full range of both public and private small-to-midsized companies is looking for answers. Governance remains a critical corporate pillar in the current environment, and it requires more audit preparation, more technology and more "man-hours."

As a result, companies are being backed into a fiscal corner. The Foley & Lardner study points out that 33 percent of respondents said compliance initiatives have led directly to critical cuts to budgets and staff. Of even greater import, 20 percent mulled the option of going private — a tremendous undertaking on its own right — to avoid the process and expense of compliance.

Companies are also driven to seek buyers to avoid compliance costs. Especially for small or private organizations that may have considered an IPO in a pre-Sarbanes-Oxley world, an acquisition strategy affords them a way out that also yields the benefits of a sale.

But compliance rears its head along this path as well, as being Sarbanes-Oxley-ready improves marketability. The value of the small company is diminished if its infrastructure is noncompliant, as integration with the new parent becomes much more daunting. Thus, even the most appealing escape route demands a sacrifice in the name of Sarbanes-Oxley.

Fighting for Value

Given the powerful undertow of Section 404, it is of course easy to fall into acceptance of rising fees with a defeatist sigh, but there are ways to take back control of the bottom line. Companies can pursue two distinct but equally important lines of attack: easing costs associated with non-audit CPA advisory services and mining governance initiatives for extended return on investment (ROI) that will pay dividends down the road.

Non-audit CPA advisory services

It is a matter of law that a public company's audit firm may not provide services including:

- valuation services
- personal tax services to client individuals in a financial oversight role
- quarterly tax provisions

While companies are aware of the need for independence achieved with this second firm, many follow a trend of paying the same fees for national CPA firms to address this non-audit work. They may, in fact, retain a second Big Four firm for these services, which calls two practical business issues into question. First, and most logically, when two Big Four firms are retained and unforeseen quality issues or conflicts arise, options to switch to yet another Big Four player are very limited.

Secondly, but of equal importance, are pricing and service levels. While there are no doubt many brilliant auditors to choose from, companies may benefit from selecting a specialized CPA firm to serve as a non-audit advisor; this arrangement can offer flexibility and attention to go along with expertise. This is especially prudent when non-audit services can extend beyond the three mandated areas mentioned above to include employee benefit plan audits and consulting work.

Major accounting firms are arguably not built for such levels of personal relationships and responsiveness. In fact, when engaged for services outside an auditor's scope, a trickle-down effect has appeared as basic mistakes are being made. This has not occurred as an isolated incident, but as a noteworthy trend that begins with restatement of financial results.

U.S. Securities and Exchange Commission (SEC) research has determined that 55 percent of recent restatements could be tracked to "misapplying basic accounting rules"

or using incorrect data, The Wall Street Journal reported late last year. According to Audit Analytics, a research firm, restatements jumped from 270 in 2001 to 1,876 in 2006.

Performing a wider search for firms that excel in high-quality non-audit CPA advisory services at more competitive rates could translate into more value and potentially more profitability.

Long-Term ROI on Sarbanes-Oxley Initiatives

In addition to gaining independence with the right non-audit advisor, companies pursuing Sarbanes-Oxley compliance — whether public companies under regulatory pressure or privates looking to increase their value — can look to gain long-term return on investment (ROI) through their efforts.

This comes as a contrarian viewpoint to the standard perception: an anonymous participant cited in the Foley & Lardner study put it most succinctly, writing that "Section 404 is by far the biggest expense and represents [the] lowest ROI."

Indeed, change strictly for compliance sake offers little to no return on investment; the only end game is regulatory security. But just as leaders can regain a measure of fee control by accessing non-audit advisory services, they can also make the most out of their compliance initiatives with a change in mindset. Instead of approaching the effort as a mandated "checkbox," those who look at compliance as part of a greater business process issue stand to gain more efficiency, control and stability as an enterprise, improving ROI.

That begins with a willingness to extract more out of the resources at hand by automating the most prudent areas of operation without losing the human touch. For example, a simple journal entry in a finance department must pass through several touchpoints before it can be officially posted.

While manual supervision remains critical, too much involvement from different personnel can lead to inconsistencies and a slower process. By automating some of these manual touchpoints, control is retained, and speed and efficiencies are gained. In the end, these efficiencies are maximized as control points and interruptions are reduced.

Taking such measures to go beyond mandated compliance requirements and enhance overall operations does take a level of forward thinking. The payoff can be enormous, however, especially in light of maximizing budgets in the face of rising auditor fees.

The idea that audit fees are influencing the fates of viable businesses is a red flag for all corporate leaders and a sign that more creative approaches are needed to catapult companies over this hurdle while maintaining profitability. The business world is always a work in progress, though, and as the situation becomes dire, proactive CPA firms are evolving to address the market need. Forward-thinking leaders can use these resources to take back control where control is theirs to take: keep non-audit costs in hand, extend ROI on compliance efforts and let their own strategy dictate their direction.

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TAKEAWAYS

>> The CPA landscape is dotted with emerging, specialized firms that aim to use their agility and more flexible fee structures to act as non-audit advisors.

>> It is becoming clear that audit fees have taken on a life beyond Sarbanes-Oxley compliance and are significantly impacting non-accelerated filers.

>> Non-audit services can extend beyond the three areas off-limits to primary audit firms, to include employee benefit plan audits and consulting work.

>> Companies that look at compliance as part of a greater business process issue stand to gain more efficiency, control and stability as an enterprise.

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