

IS THE ASSOCIATION AUDIT A COMMODITY?

By: Gary A. Porter, CPA

Has the annual audit been degraded from being a highly sought after professional service to being viewed as a simple commodity, where all audits are considered equal? I think not, but many associations, as well as some CPAs, apparently think otherwise. Why else would we have a situation where the “low bidder” routinely gets the job, and the association pays little, if any, attention to the CPA's qualifications? It seems the only time someone actually cares about the CPA's qualifications is if the audit goes bad, for instance, when embezzlement goes undetected. The situation is bad, but not hopeless.

The present state of affairs is reminiscent of California governmental audits in the 1970's. Since those audits were public information, the State Auditor's office was able to conduct a study, and found errors in 92% all of the thousands of state governmental subdivision audits, more than 80% of which were considered significant errors. A commission was formed, guidelines were drawn up, and mandatory education was required for all CPAs who wanted to perform governmental subdivision audits. Further, all governmental subdivisions were required to abide by certain bidding procedures that placed consideration of the CPA's qualifications first, and fee last, with no more than 25% of total consideration being given to fees. Many governmental agencies established a two-step selection (not bidding) process where (1) non-fee proposals were made based on qualifications and selected criteria, and then (2) only the qualified proposers were requested to submit a fee proposal. As a result, the statistics were reversed over a 15-year period. More than 90% of governmental audits were error free by 1990. One of the most significant findings of the commission was that audit services are considered to be professional services that should

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not necessarily be subjected to the bidding process required for products purchases or non professional services.

Notably, in the 1970's, most auditors were selected based upon the lowest bid. The governmental audit was viewed simply as a necessary evil, to be completed as quickly and cheaply as possible. In the 1990's, there are far fewer CPA firms performing governmental audits, but they are far more qualified than the average CPA firm of the 1970's. While I doubt that the error rate in association audits is as high as it was with governmental audits in the 1970's, the perception of the audit process by the consumer (client/association) appears to be the same as that of governmental agencies from that time period.

Let's take a look at how the audit process has evolved. Audits of business organizations have been routinely performed dating back to the 1860's. British Chartered Accountants in England, and CPA's in the United States, performed audits for business organizations who voluntarily subjected themselves to the annual ordeal. That is, until the stock market crash of 1929. After 1929, in the United States, the Securities and Exchange



Is the Association Audit a Commodity? (cont'd)

Commission (SEC) was created which mandated audits of publicly held corporations.

But if these requirements eliminated, would audits still take place? For most publicly held corporations (and for many associations) the answer would still be "yes." You have to understand that the reason why audits were created in the first place was to address the issue of principle-agent problems. The Principles, the shareholders of a corporation (or members of an association) were trying to devise a mechanism to keep track of the corporate managers (agents) that they employ, because the two at times have conflicting interests. The financial statement audit was considered to be the primary tool for keeping track of the agents and keeping them honest. Thus, the audit is really an insurance policy for the principles. This is also one of the reasons why professional liability insurance costs so much for performing audits. The CPA is in the position of managing risk just like an insurance company is in the business of managing risk. Therefore, CPA's who perform audits are really in the risk management business. They are not auditors. But few CPA's think of themselves in that way and virtually none price their audits in that manner.

Instead, CPA's have paid homage to the almighty hour, and have treated all their audits the same by classifying the risk as being equal to the amount of hours expended to complete an audit. This gives no regard at all to the external value provided to the end user, the corporate shareholder or member of the association. It is on this basis that the audit has become commoditized to the extent that it has. CPA's have never been adept at conveying the value of their services, and this is nowhere more apparent than in the performance of audits. CPA's have let the customer (client/association) beat us into submission, convincing us that the audit is nothing more than a commodity. CPA's have confused the client's excessive fee haggling as a sign of their price consciousness. But customers are not price conscious for things they want to buy. If price were

the only consideration in buying a car, the now defunct Yugo would be the best selling car in the world. It had the lowest price. But, it also had the lowest quality, so hardly anyone bought it. CPA's have almost universally failed to engage in the practice of discrimination of clients based on risks.

Add to this mixture an analysis of the product (service) itself. If you were to analyze the audit service as a product and look at its product life cycle, the audit is clearly not in the introduction or growth stage, it perhaps not even in the maturity stage. It is probably somewhere between the maturity and decline stages. Statistics indicate that audit revenues for all CPA firms have declined significantly in the last ten years at the same time that the gross domestic product has increased dramatically. One reason for this is the consolidation of a number of large corporations as well as of large accounting firms. The reason for both of these organizations to be consolidated is not necessarily to reduce competition, but rather to eliminate business redundancies and therefore improve efficiency.

If the audit is viewed as a commodity, and it's only because CPA's have allowed it to become one. The fact is, the CPA has the ultimate monopoly, as no one else but a CPA can perform an audit. If a CPA says that his audits are a commodity, in fact, he is saying that he and his firm are commodities. However, I believe that there really is no such thing. Any "product" can be differentiated. Unfortunately, CPAs are not noted for being the most creative people in the world, and most in the homeowners association industry have elected to differentiate based on fee alone. Also, in the homeowners association industry, the insertion of the management company between the CPA and the board of directors often means that no real client relationship is ever established. This is unique to this industry.

Professional services are inherently personal in nature, but a CPA will never get paid more than you think you're worth, and if CPA's seem to lack self-



Is the Association Audit a Commodity? (cont'd)

esteem and do not believe they are worth the premium dollar, then neither will their clients. If CPA's do not have the ingenuity and creativity to differentiate their audits from those of their competitors, then perhaps they deserve the commodity prices they receive.

In general, CPA's have failed to educate their clients to the fact that the services they provide are unique, particularly in the association industry. Most associations seem to believe that all CPA's and the services they perform are equal, and the audit itself is of little consequence, and in fact is a commodity. This is a troubling perception. What it indicates is that audit prices are being set by our dumbest competitors. That is those who are charging based on the hours spent, rather than the risk assumed, and are charging a minimal price or hourly rate at best for their services.

The audit is a good example of the service that could command a significantly higher price than it is receiving in the market. It is in fact not a commodity, and a CPA should not allow it to become one unless of course, you are a commodity.

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