

# CPA management advisory services: Valuable tools for small businesses

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## ABSTRACT

*This study was conducted for CPAs' opinions concerning small business and CPA services. Specifically, management advisory services were identified that are offered by CPAs and are important to small business. The results indicate CPAs receive 78.1 percent of their gross income from small business. Management advisory services identified as important were financial analysis, computer services, strategic planning, business acquisition/disposal, expense controls, and marketing strategies.*

## INTRODUCTION AND LITERATURE REVIEW

Studies have been conducted concerning perceptions of what makes a small business a success or a failure. In many of these studies, lack of management abilities or expertise has been cited as an important reason for failure. It has also been recommended that one of the best ways to reduce the number of small business failures is to increase management education. There are a number of areas then where a qualified business advisory professional could help a small business owner/manager become more informed. One of these professionals is a CPA. The traditional role of the CPA has been as a tax preparer and an auditor. The question arises as to the perception of the CPA in relation to small business and the nontraditional management advisory services that they can provide to increase the information needed by small business.

A public opinion poll conducted by Louis Harris and Associates (1986) attempted to measure the general public's perceptions of CPAs and their knowledge of CPA qualifications. The poll revealed a large number of people think CPAs should offer their services in a number of diverse areas. These included computer services, general management consulting, educational programs, actuarial services and service bureaus for recordkeeping. CPAs can serve a number of roles including auditor, small business advisor, financial planner, tax advisor, and management advisory consultant. The CPA has a broad background which can be used to meet the needs of small business concerning management advisory services.

The SBA compiled the following statistics for small business in the U.S. in 1988. Total employment rose 3.2 percent from April 1988 to April 1989. Unemployment was 5.3 percent in April of 1989. In the small business-dominated industries of construction, retail, wholesale, and service sectors, employment rose by 3.3, 2.6, 3.7, and 5.3 percent from April 1988-89, respectively. The SBA reports 21 percent of exports are from small business. U.S. exports were \$30.8 billion in April 1989. Approximately 22.3 million new jobs were created in the U.S. between 1976 and 1986. Small business accounted for 57.2 percent of these jobs. Small business owned 89.2 percent of the 5.8 million business establishments in 1986. From 1987 to 1988, business incorporations decreased 0.2 percent, business bankruptcies decreased 22.8 percent, and business failures decreased 6.6 percent. The problem is two-thirds of small businesses go out of business in less than four years.

Studies have been conducted concerning perceptions of what makes a small business a success or a failure. Ibrahim and Goodwin in 1984 designed a study to identify variables associated with a successful small business and developed a profile of the successful manager. Managerial skills for successful businesses include a niche strategy, budget control, education, a simple organizational chart, and an effective management of cash flow.

In a study done by O'Neill and Duker in 1984, strategies used by successful and failed small businesses were examined. This study found accountants provide information critical to the success of the small business. No other advisory source including lawyers, bankers, boards of directors, customers, suppliers, government agencies and the SBA correlated significantly with success.

The Small Business Administration estimates 90 percent of business failures are due to poor management abilities. Management abilities were defined as accounting, marketing, financing, and other problem-solving skills. A study conducted at the University of Texas at Austin in 1983 by Peterson, Kozmetsky, and Ridgway found that lack of management expertise is the primary cause of failure in small business. Increased management education was listed as the best way to reduce the number of small business failures.

These studies support the fact that poor managerial skills are one of the major causes of small business failure. These are areas where a qualified business advisory professional could help a small business. So for a small business to succeed, where do they turn to improve their management skills or information? Arnold, Cherry, Diamond, and Walker in 1984 found the CPA is considered the primary external adviser for small business. However, only 25 percent of the small businesses surveyed viewed the CPA as very important in meeting their management needs.

Peat, Marwick, Mitchell & Company found independent accountants are the number one resource used by executives when they cannot find the help in their own company. Accountants were ranked as being used almost twice as often as bankers. In choosing an accounting firm, expertise ranked first with a rating of 85 percent, previous experience 65 percent, key contact 63 percent, and reputation 59 percent.

Gobeli and Seville (1989) looked at small business and the CPA interface. Their survey was developed after a number of complaints by small business owners who were not happy with the time it took to collect information for tax returns and the limited management information received from those returns. The current CPA interface with small business is primarily as a tax return preparer.

The Gobeli and Seville (1989) study also looked at the perceptions of small business managers who needed CPA services and how they viewed the qualifications of CPAs to provide them. About 90 percent of small business managers felt CPAs were qualified to do tax returns, although 100 percent needed tax returns. The reason business managers did not feel CPAs were qualified was because they did not understand their business.

The same trends continued concerning CPA management advisory services and their qualifications to do the job. These services included business plans, marketing plans, business consulting, computer systems, and new venture planning. On the average, 60 percent of the businesses needed these services while only 30 percent felt the CPA was qualified. The research concluded opportunities exist for growth in management advisory services. However, the CPA must not only know the business but also have knowledge in the skill he/she is providing.

In a recent article of the Journal of Accountancy, the number-one complaint of small business owners is that advisors do not understand their businesses. They cited several considerations for a CPA wishing to service small businesses. The CPA's education should be broad. Small business experience is essential. The CPA must be able to communicate and to implement the recommended solution.

A ten-month study by Siegel discovered a large market for management advisory services that may be unserved by CPAs. The main areas determined where small businesses may hire consultants are personnel, marketing, computers, expansion planning, strategic planning, acquisitions, financing and compensation planning.

This current study focused on the nontraditional, mainly management advisory services (MAS) which CPAs can provide to small business. Traditional services are defined as audit and tax. CPAs were polled on small business issues and the services they provide to small business. The level or amount that is estimated or expected to be found in these areas has been developed from the literature.

## METHODOLOGY

This study looks at the present opinions of Iowa CPAs, who are members of the Iowa Society of Certified Public Accountants, concerning small business in Iowa. It is a post facto, non-experimental, descriptive study.

A questionnaire was mailed to a total of 632 members of the ISCPA who are practicing in the public accounting field with five or more years of experience. The questionnaire contained 19 questions covering three pages. Most of the questions were structured or fill in the blank. A cover letter was included explaining the study. For the purposes of this study, small business was defined as business with 50 employees or less.

## ANALYSIS

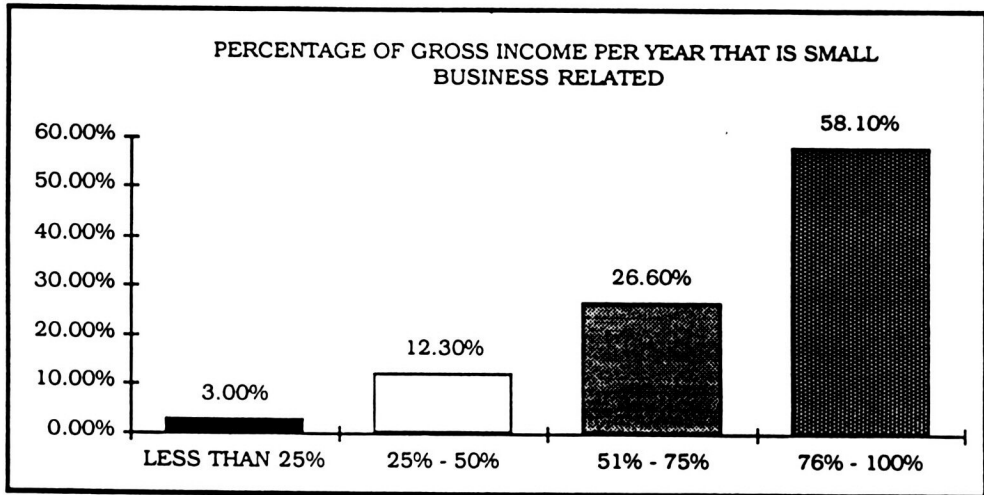
Of the 250 questionnaires returned, there were 245 usable responses with a return rate of 38.8 percent. The largest amount of returns, 141, were received from local CPA firms, 69 were received from sole proprietors, and regional and national firms submitted 17 and 16 returns each. The data were then coded and entered into an SAS statistical program.

## RESULTS

The results are presented by hypotheses issue or service. The first issue had to do with gross income per year. It was thought that over 83% of CPAs' gross income per year is from small business. It was actually found in these results that over 50% of CPAs obtain 80% or more of their gross income from small business. Nine people did not respond. This area is not supported because of a mean score of 78.1%.

Mean = 78.1%  
Range = 0-100%  
Mode = 100

**Figure 1. Percentage of Gross Income Per Year That Is Small Business Related**



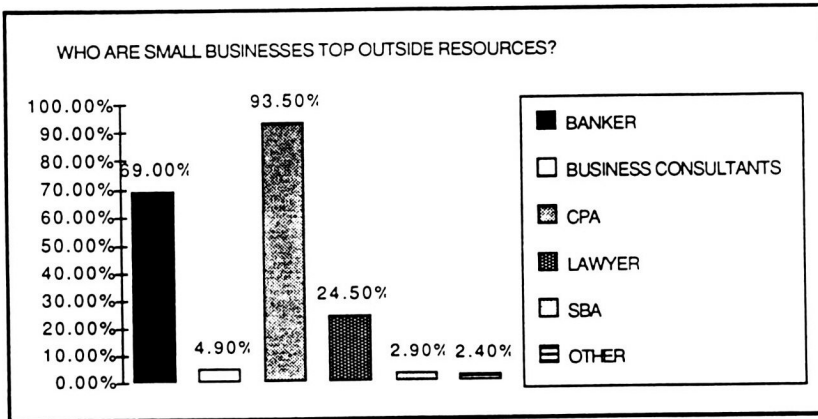
The second issue had to do with professional qualifications. It was estimated that over 50% of CPAs would rank tax knowledge as the most important professional qualification to meet the needs of small business. CPAs were asked to rank on a scale of 1 to 5, with 1 being most important, qualifications they perceived as being most important to meet the needs of small business. The rank means show small business experience is most important followed closely by tax and communication skills. Other items mentioned included MAS services, training, hand holding, an analytical mind, and baby sitting skills. There were three CPAs who did not respond.

**Table 1. CPA Qualification Ranks to Meet the Needs of Small Business**

	RANK MEANS
Small Business Experience	1.80
Tax Knowledge	2.33
Communication Skills	2.61
Broad Education Background	3.85
Computer Skills	4.44

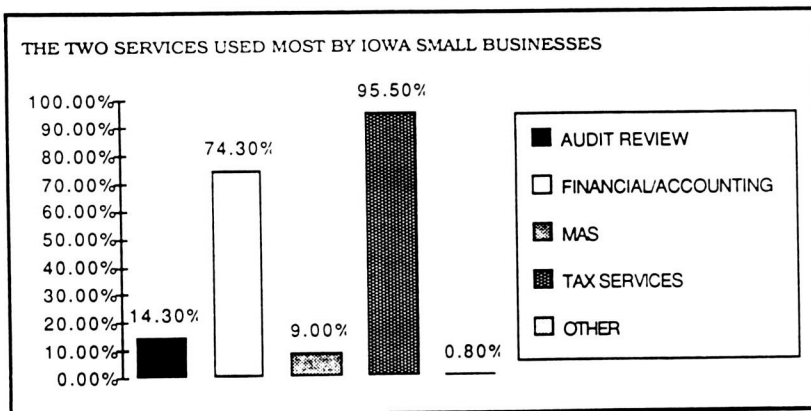
The third area that was investigated involved the choice of resources for advice to small businesses. CPAs were asked to check two of the following categories: Banker, Business Consultant, CPA, Lawyer, SBA, or other. Of those responding, 93.5% ranked CPAs as a top outside resource. Bankers ranked second with 69%. This supports previous research. Other resources mentioned include business associates, clients, peers and friends. Everyone responded.

**Figure 2. Who Are Small Businesses' Top Outside Resources?**



The fourth area of concern had to do with the services used by small business. It was thought that CPAs would choose audit/review and tax services as the services used the most by small business. The results indicated that CPAs viewed tax services (93.5%) and financial/accounting (74.3%) as the two services used the most by Iowa small businesses. Only 14.3% of those surveyed viewed auditing as one of the two services used the most. One CPA did not respond.

**Figure 3. The Two Services Used Most by Iowa Small Businesses**



CPAs were asked to rank the number one MAS service needed by Iowa small businesses. They were asked to rank the top five most needed management advisory services. Financial analysis was ranked 192 times, computer services 147, strategic planning 146, expense controls 144, marketing 97, and business acquisition/disposal 84. Evaluation of the rank means determined that financial analysis is first, strategic planning second, expense controls third, computer services fourth, marketing fifth, and business acquisition/disposal sixth. Five people did not respond. See Table 2.

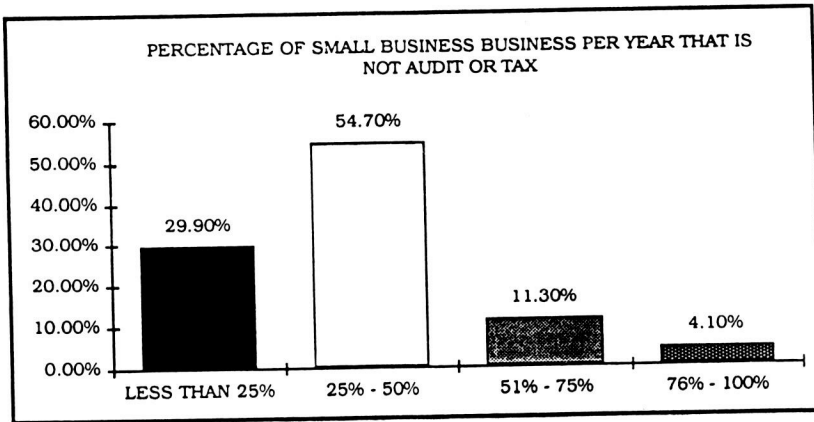
**Table 2. MAS Services Small Businesses Need the Most**

	Number Responses	Rank Mean	Rank
Business Acquisition/Disposal	84	3.23	6
Business Valuation	42	3.55	
Computer Services	147	3.18	4
Employee Compensation	56	3.59	
Expense Controls	144	2.82	3
Financial Analysis	192	2.02	1
Human Resources	50	3.46	
Insurance Consultation	19	4.47	
Internal Controls	74	3.39	
Lease vs. Buy Analysis	17	4.18	
Litigation Support	9	4.11	
Marketing Strategies	97	3.20	5
Pre-Loan Preparation	74	3.23	
Strategic Planning	146	2.65	2
Other	7	1.71	

A question was asked dealing with what percentage of business per year was not audit and tax related. It was thought that over 60% of a CPA's small business would be audit and tax. The mean score was 35.6%, so 64.4% of a CPA's business is audit and tax preparation. 84.6% said less than 50% is audit and tax. Four did not respond.

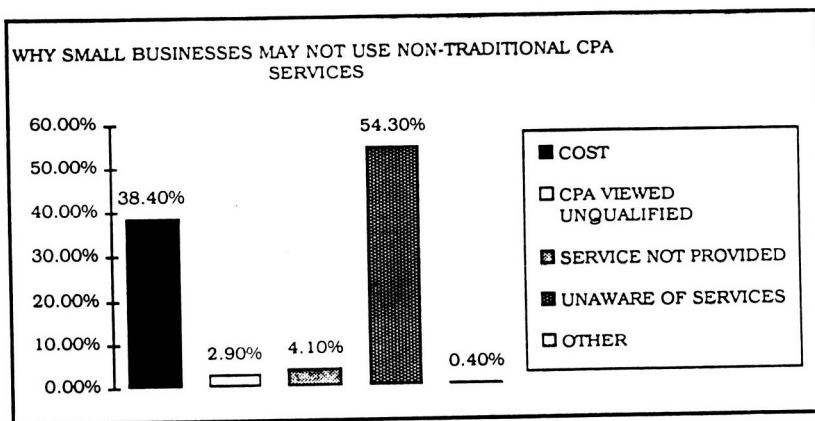
Mean = 35.6  
 Mode = 30%  
 Range = 0%-100%

**Figure 4. Percentage of Small Business Business Per Year That is Not Audit or Tax**



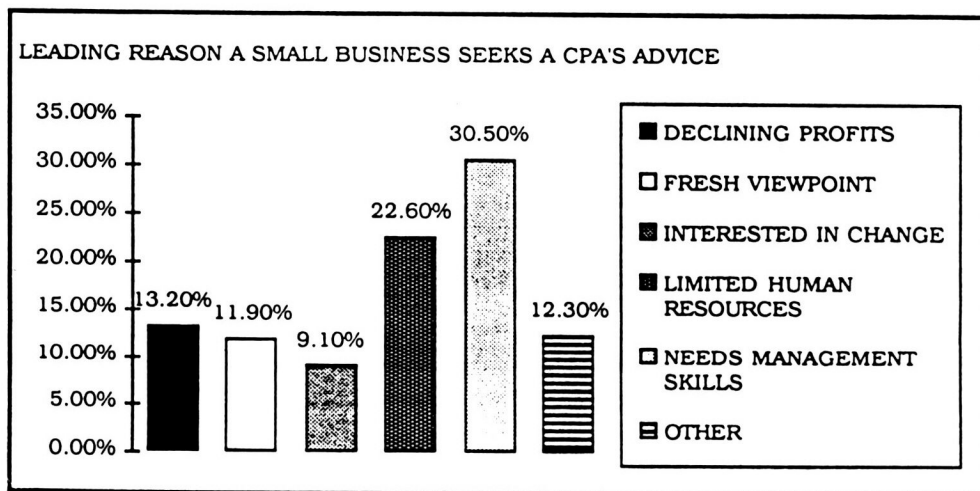
The CPAs were then asked their view on providing services other than tax and audit. It was estimated that over 50% of the CPAs would say small businesses view them as unqualified to provide services other than audit and tax. However, only 2.9% of the CPAs surveyed felt small business viewed them as unqualified to provide services other than audit and tax. Unaware of services was the main reason at 54.3% and cost was second at 38.4%. Everyone responded.

**Figure 5. Why Small Businesses May Not Use Non-Traditional CPA Services**



A need for management skills was thought to be the response that over 50% of the CPAs would say is the leading reason a small business manager seeks a CPA's advice. A need for management skills was listed 30.5% of the time. Limited human resources was second at 22.6%. Of the 30 CPAs answering other, 23 answered the leading reason they are sought is for tax planning. Four answered that their advice was a requirement of the bank. Combining limited human resources and management skills netted a percentage of 53.1%. One CPA thought the question was poorly written. Two did not respond.

**Figure 6. Leading Reason a Small Business Seeks a CPA's Advice**



### OTHER FINDINGS

Another question asked for the CPA to rank the most important reason why a small business client seeks CPA services. Referrals from other small businesses (2.31) and the CPA's image/reputation (2.43) ranked as most important. Reasonable fees (4.18) were not perceived as an important reason. Other reasons cited included bank referral, tax problems, and financial problems. One CPA thought it was a bad question and another responded that this was why one CPA is chosen over another. Five people did not respond.





**Table 3. Reasons Small Business Clients Seek CPA Services**

	1	2	3	4	5	Rank Mean
Referrals from Small Business	89	63	32	34	21	2.31
CPA's Image/Reputation	69	68	51	34	18	2.43
Depth/Breadth of Services	54	30	61	50	41	2.97
Personal Relationship	18	61	58	65	36	3.17
Reasonable Fees	3	17	37	55	123	4.18

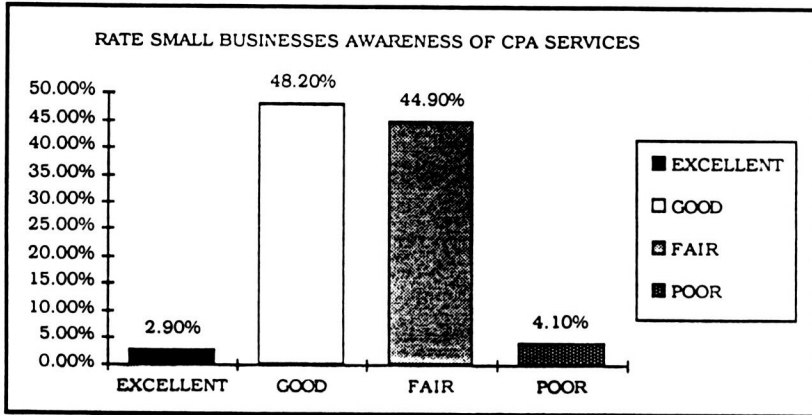
The five most provided MAS services include financial analysis (90.8%), business acquisition/disposal (90.0%), computer services (85.0%), pre-loan preparation (82.9%), and lease versus buy analysis (81.7%). Other MAS services mentioned include financial planning, successor planning, retirement planning, cash management, health care, inventory control, and investment advice. National firms also offer telecommunications services.

**Table 4. MAS Services Provided by CPAs**

	Number Responses	Percentage
Business Acquisition/Disposal	216	90.0
Business Valuation	159	66.3
Computer Services	204	85.0
Employee Compensation	152	63.3
Expense Controls	165	68.8
Financial Analysis	218	90.8
Human Resources	60	25.0
Insurance Consultation	51	21.3
Internal Controls	174	72.5
Lease vs. Buy Analysis	196	81.7
Litigation Support	109	45.4
Marketing Strategies	56	23.3
Pre-Loan Preparation	199	82.9
Strategic Planning	146	60.8
Other	15	6.3

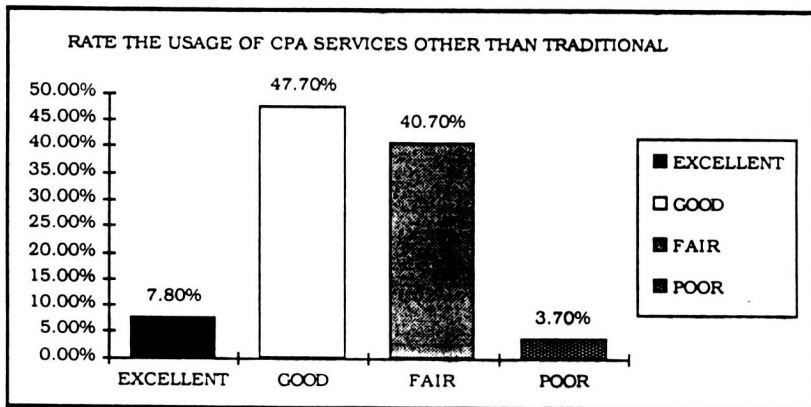
The CPAs were asked to rate the level of awareness of small business owners concerning CPA services. The majority, 93.1%, rated small business owner awareness as fair to good. Only 51.1% rated them good to excellent. Only 2.9% rated them as excellent.

**Figure 7. Rate Small Businesses Awareness of CPA Services**



CPAs were asked to rate the use of their services other than traditional (audit and tax). The majority (88.4%) rated small business use of non-traditional services as fair to good. Only 3.7% ranked them as poor. This is surprising since 54.3% cited small businesses as being unaware of services as the single most important reason why they may not use non-traditional services. Expectations were for a larger percentage to be ranked fair to poor.

**Figure 8. Rate the Usage of CPA Services Other Than Traditional**

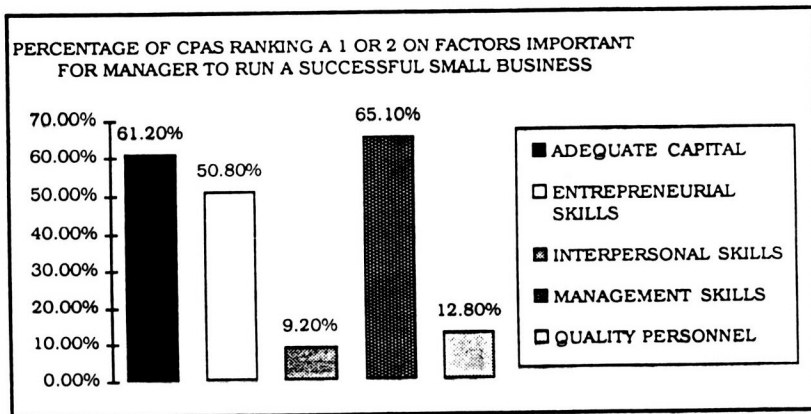


When asked to rank the major factor that affects an owner/manager's ability to run a successful small business, management skills ranked number one (2.19) followed by adequate capital (2.31).

**Table 5. Factors Affecting An Owner/Manager's Ability to Run a Successful Small Business**

Adequate Capital	2.31
Entrepreneurial Skills	2.66
Interpersonal Skills	4.03
Management Skills	2.19
Quality of Personnel	3.79

**Figure 9. Percentage of CPAs Ranking a 1 or 2 on Factors Important for Manager to Run a Successful Small Business**



Opportunities exist for CPAs in strategic planning and marketing strategies. Only 61% provide strategic planning services and this is seen as the second best service in terms of growth potential and importance to small business. Marketing is seen as important and also offers growth potential; however only 23% of those surveyed provide this service. Expenses control is another area where opportunities exist. Only 69% provide this service and it is seen as the third most important for small business. Service areas that are important, growing, and offered by a large percentage of the CPAs surveyed include business acquisition/disposal, computer services, and financial analysis (see Table 6).



**Table 6. MAS Services Small Business Comparison**

	Provide Service	Need Service	Growth Rank
Business Acquisition/Disposal	90.0%	6	4
Business Valuation	66.3%		
Computer Services	85.0%	4	1
Employee Compensation	63.3%		
Expense Controls	68.8%	3	
Financial Analysis	90.8%	1	3
Human Resources	25.0%		
Insurance Consultation	21.3%		
Internal Controls	72.5%		
Lease vs. Buy Analysis	81.7%		
Litigation Support	45.4%		
Marketing Strategies	23.3%	5	5
Pre-Loan Preparation	82.9%		
Strategic Planning	60.8%	2	2
Other	6.3%		

## CONCLUSIONS

Small business accounts for a large percentage of the businesses and employment in the United States. It is important to keep these businesses healthy to avoid drastic changes in the economy. Research shows that most small business failures are due to a lack of management skills. Certified Public Accountants provide a number of management advisory services that small business owners/managers can use. A large percentage of the CPA firm's gross income, 78.1%, comes from small businesses with 50 employees or less. CPAs and bankers topped the list of the two most used outside resources. Tax services and financial/accounting are the two services used most by small business. Referrals from other small businesses is one of the most important reasons small business clients seek CPA services.

It is crucial for small businesses to avail themselves of the services that are available through Certified Public Accountants. CPAs are well respected by the public and the business community. Years of training, education, and experience make a CPA a qualified business consultant. CPAs need to demonstrate to the small business owner/manager that they possess the necessary small business experience and the tax knowledge that small businesses need. Working together is in the interest of the CPA and the small business owner. It appears that CPAs need to spend some time educating and building confidence in the services that they can deliver to the small business owner/manager.

## ACKNOWLEDGMENTS

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