

# [Business ethics 17792](https://assignbuster.com/business-ethics-17792/)

[Business](https://assignbuster.com/essay-subjects/business/), [Marketing](https://assignbuster.com/essay-subjects/business/marketing/)

Accounting Ethics

When examining the effect of open marketing on the profession of

accounting it is important to view it from three perspectives: the

client's, the profession's, and society's. Additionally, two key areas

that are affected by marketing must be addressed,

these are concerning competition, and ethical implications. Marketing in

public accounting is here to stay therefore making an argument against its

existence would be fruitless; however, in order to achieve maximum benefit

to the firm, the client, and s ociety more stringent guidelines must be

implemented at the firm level.

The first, and most obvious, of the effected areas is competition.

Within competition several points are discussed. First, the implications

advertising has on public accounting-- the model of perfect competition

versus the model of monopolistic compet ition. Secondly, the relationship

between firm size and advertising expenditures. Thirdly, the effect of

advertising on firm specialization, the implications of client turnover on

public accounting practice.

Before making the comparison, a brief explanation why the two

models are chosen is in order. Monopolistic competition has been chosen

for the pre-advertising era because it most closely resembles the market

structure in an extreme sense. The elements o f monopolistic competition

are as follows: product differentiation, the presence of large numbers of

sellers, and nonprice competition. Although accounting services between

firms offer very little service differentiation, the absence of

advertising serve s as a replacement because clients are not necessarily

aware that other options are easily attainable. The post-advertising era

is explained through the model of perfect competition for which the

qualifications are as follows: very little or no service d ifferentiation,

many sellers, and price as the only means of distinguishing one firms

service from anothers.

In a perfectly competitive market the price of a particular

service is established solely by the interaction of market demand and

supply. (Thompson p. 277) When market demand for accounting services

increases the resulting demand shifts right causing pri ces to increase

returning the market back to equilibrium. However when supply increases,

such is the theoretical effect of adding advertisement to public

accounting practice, the supply curve shifts right causing prices to fall.

The model of monopolistic competition is also price sensitive,

however only at the firm level. For example, the CPA firm of XYZ has an

established clientele base and uses referrals as its sole means of growth.

They increase prices only as their cost o f providing the service

increases and therefore are able to maintain their client base. In this

example a gently downsloping demand curve exists (Thompson p. 304) causing

only drastic changes in pricing to send their client base shopping for a

new firm. The result is XYZ can continue to grow by practicing fair

pricing and providing a reputable service. Cut rate pricing only

marginally effects their client base because there is little means to make

their pricing publicly known, and only drastic, unwarran ted increases

sends clients packing.

Conversely, in the post-advertising era, XYZ must always be aware

of market pricing because the demand curve is steeper and more volatile.

Therefore the client base of XYZ is not stable as in the previous example

and measures must be taken to keep price s competitive with other firms

regardless of cost inferences. The result is the necessity of a more

aggressive policy regarding new client recruiting and a higher turnover of

existing clients.

Now that the differences are established, the resulting issues in

public accounting can be discussed. The first area deserving discussion

is the relationship between firm size and advertising. expenditures. A

study made of CPA firms in Britain in 1985 asserted " the most dramatic

contrast between advertisers and non-advertisers was their size."

(O'Donohoe p. 122) The obvious reason for this anomaly is availability of

resources. Larger firms ha ve, at their disposal, a much larger profit

level; therefore advertising expense is easily included only marginally

affecting bottom line. This implies larger firms to have gained a great

deal more from inclusion of advertising than small firms. Consequ ently,

small firms could be pushed out of the picture entirely in the area of

audit services.

Why? In the area of audit services, small firms have little to

offer to differentiate themselves from their larger counterparts who can

now freely move in and perform the service at a lower price. This,

unfortunately, will be a byproduct of the adverti sing era. Smaller firms

only hope is to emphasize " personalized service" in tax and full service

areas in hope that audit services can result. The major drawback is small

firms are offered little room for growth because of the expense involved.

Adverti sing in public accounting causes perspective clients to become

bottom line oriented meaning the firms with the most available revenue to

dump into advertising, coupled with the resources to offer lowest fees are

the ones which grow. These resources are h eld by Big Six firms and large

regional firms. As a result these firms will grow while small firms

struggle.

The second inference drawn from the model of perfect competition

is some smaller firms being forced to specialize. In order to

differentiate themselves some smaller regionally operated firms have

chosen to specialize. In the March 1990 issue of the CPA

Journal Arvid Mostad, CPA published an article in which he set up " Seven

Marketing Guidelines." His first guideline was " Create your own special

niche." (Mostad p. 54) He goes on to encourage small firms to establish an

area of expertise. (Mostad p. 54)

This develops significant implications regarding firm longevity in a

capitalistic market of industry upswings and downturns. An example of

this is the construction industry in the Baltimore-Washington corridor.

The industry experienced phenomenal growt h in the Eighties followed by a

near halt. The result? many small to medium size firms following the

advice of specialization went belly up along with their clients. This

uncertainty exists with any firms who specialize. !

Firm specialization clearly is n

The final implication of the new competitive market is client

turnover. Gone are the days when firms could guarantee retaining a client

by providing a quality service at a fair price. New market pressures

require firms to constantly evaluate pricing st rategies, and, in some

cases bid on jobs yearly. This creates high levels of client turnover.

The result is firms must always actively seek new clients. Several

drawbacks of this are increased overhead costs to firms, less stability,

and greater servic e cost. Firms overhead costs increase because the

expenses of replacing clients must be absorbed. This expense comes from

both marketing tools used to attract clients, and costs of preparing a bid

to perform a service. Firms which previously served a client base from

year to year must face the uncertainty of retention of their client base

now. The cost of providing a service to a new client greatly exceeds that

of providing the same service to an existing client. When !

providing a service to a new clie

Now that the difference in the competition aspect of public

accounting is established emphasis is changed to examine the ethical

implications derived as a result. In the area of ethics one must examine

differences in independence, and integrity, and eva luate the changes in

quality of service resulting from these areas.

When examining independence one must maintain an emphasis on the

competitive structure of the market and new pressures in the area of

client retention. Independence, one may argue, never existed before;

however an assumption is made that independence, t o some extent,

historically exists. With the competitive structure now present the

process of gaining a new, and retaining an existing, client has become

increasingly costly and time consuming. One may then infer that once a

client is obtained, a firm would wish to do business with that client for

an extended number of years, in order to realize the benefit of expenses

incurred. Put simply, a firm would not look kindly toward a partner who

lost a new client. This, inherently, decreases auditor indep endence

during the first several years of the engagement. The partner overseeing

the audit must always concern himself with the consequences of losing the

engagement. Previously, firms worked mostly with longstanding clien!

ts and the relationship developed

The second major area of ethical effect is that of integrity.

Competition has resulted in some firms damaging the integrity of the

profession. This damage has occurred mainly through pricing practices.

Two deviant practices have become commonplace in today's market. These

are below cost pricing, and discount pricing. Many firms have adopted

policies of below cost pricing as a tool of market penetration,

(Formichella p. 199) implications regarding the motives and integrity of

these firms must be explo red. Is it reasonable to assume that a firm

would be willing to absorb a loss from an engagement, or would a more

practical assumption state that firms which lowball would seek means to

cut service costs at the expense of quality? It is not possible to answer

this question; however its mere existence creates a damaging effect on the

integrity, or at least perceived integrity, of the profession.

The second pricing strategy which is cut-rate pricing provokes

similar questions. In his commentary Mario Formichella states the

following:

It is no longer unusual to find firms willing to

take on work at substantial discounts from standard

fee levels. While there may be justifications for

performing services at reduced rates during off-peak

periods in special situations such as for non-profit

institutions or similar organizations, the extent to

which this practice has grown cannot be justified

on any logical or professional basis. (Formichella p. 81)

The distaste shown by Mr. Formichella in the area of cut-rate pricing

shows it as an issue of concern and one which damages integrity. Mr.

Formichella goes on to call for the implementation of professional

standards to prohibit actions such as this which

are damaging to the image and integrity of the profession. One would

have to agree with his statement; however difficulties arise, in the area

of monopolistic activity when guidelines are established regarding pricing

strategies across an industry. Unf ortunately the profession must rely on

the integrity of individual firms to guard against this strategy. As a

result, this is a practice likely to continue, albeit damaging to the

profession and those which rely on the statements made by the profession.

The existence of advertising in public accounting creates a new

environment to which firms are still adapting. This new environment is

largely the result of increased competition and a clientele which is

increasingly more bottom line oriented. In order

to compete firms must place more emphasis on marketing and accept it as a

cost of doing business. The result of this will be more difficult

penetration and an increasingly limited number of small firms in the

business. Market pressures also are forcing

creating situations where ethical issues such as independence and

integrity are questioned making it imperative that the AICPA create

guidelines from which the evolving profession must base itself. In the

age of deregulation accounting jumped on the boa t, now it is becoming

increasingly fashionable to re-regulate, accounting, as a profession must

not miss that boat, lest they drown in the result-- government

intervention.