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ACCOUNTING FIRMS: COVER STORY

Accountants move beyond number crunching to more profitable pursuits

Plain-vanilla auditing just doesn't do it for accounting firms any more. They are turning toward sexier, higher-margin pursuits like cybersecurity and forensic number-crunching

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Like visiting the dentist or getting an oil change, accounting firm clients tend to view having their books periodically audited as a necessary evil. And it's one they'd prefer to pay as little for as feasible.

For accounting firms, that can quickly lead into a race for the bottom. "A lot of the audit work is being commoditized," said Kathleen Ryan, CEO of finance and accounting consulting firm RoseRyan in Newark. "Firms do this all the time. They go down to the lowest price, trying to grab market share and it's just not as profitable."

So in recent years, many accounting firms have moved to counter the trend by branching out into sexier lines of business: conversation-starters like cybersecurity consulting, forensic accounting in support of fraud investigations — even, in at least one case, robotics.

Accountants "are looking beyond their core services and looking at where they can add value for their clients," Ryan said. Her firm has added a Revenue Recognition service to help companies prepare for changes in accounting standards coming in 2018, and a service to help companies that have gone public adjust to higher accounting and disclosure requirements.

In one of the higher-profile moves toward diversification, the Big 4 firm KPMG LLP acquired Redwood City-based Qubera Solutions Inc. in late 2014. The cybersecurity firm advised Fortune 500 and Global 2000 clients on identity and access management.

"Clients are really trying to get some help around the increasing risks of protecting your own information," said Debbie Messemer, KPMG's managing partner in San Francisco.

KPMG's core audit, tax and advisory services are still growing at a good pace, Messemer said. But the firm is still adding services to help its clients expand into new businesses and overcome challenges like data security.

"It's just making sure we continue to be relevant in our market," Messemer said.

KPMG has also acquired at least two other businesses, in the past two-and-a-half years, to improve its technological expertise. In early 2014 KPMG acquired Cynergy Systems Inc., a Baltimore-based firm that advised companies on digital mobile technology. And in late 2013, it purchased Link Analytics LLC, an Atlanta-based data analytics firm.

KPMG also offers a "Robotic Process Automation" consulting service to help companies implement systems with robotics, machine learning and advanced analytics.

Tech remakes the market

Technology is a common theme in the expansion at many accounting firms, as advancements in technology drive demand for increasingly specialized levels of expertise.

Hemming Morse LLP, with offices in San Francisco, San Mateo, Walnut Creek and Santa Rosa, was already a specialist, focusing on forensic accounting, financial consulting and auditing of employee benefit plans. But in recent years, the firm has had to develop more expertise in data analytics, said Greg Regan, the partner in charge of Hemming's forensic and financial consulting services group. Two of the firm's accountants have even gone back to graduate school to acquire that knowledge, he said.

In the past, a big forensic accounting project might have involved the analysis of 1 million transactions, Regan said. Now, with more computing power available to companies, such a project might involve analysis of 100 million transactions.

"It's just not possible to analyze anywhere close to that," Regan said. "But computing power can filter documents down to a manageable amount."

Enron's legacy

The diversification of the accounting business also represents a return to its recent past, noted Jack Russi, a vice chairman and national managing partner for Deloitte LLP in San Francisco. The big auditing firms were all known for their consulting servings, as well as accounting, until the early 2000s. Then came the Enron scandal, and the collapse of its auditor, Arthur Andersen LLP. Enron was a major customer of Andersen's consulting services, as well as an audit client. The relationship came to be viewed as a conflict of interest that could have influenced Andersen to sign off on Enron's later-disgraced accounting practices.

The Enron scandal led to the passage of the Sarbanes-Oxley Act, which set new rules meant to assure auditors' independence from their clients and limited their ability to sell other services to audit clients.

At the same time, technology companies were looking to acquire consulting practices. PriceWaterhouseCoopers LLP sold its consulting practice to IBM. KPMG spun off its consulting business, creating BearingPoint. Ernst & Young sold its consulting business to Cap Gemini.

The sales generally included provisions that banned the accounting firms from competing with the consulting businesses they had sold, Russi said. But in recent years, those agreements have expired.

“The reason why they’re motivated (to return to consulting) in my view is that the markets that you’re talking about are growing much faster than the core audit and tax business today,” Russi said. “If you look at KPMG, PwC and E&Y, they are still very heavily weighted to audit and tax.”

Deloitte was the only one of the Big 4 that did not sell its consulting practice. It has acquired more than 40 businesses in the last 10 years, Russi said.

Lawrence Wood, managing partner of DZH Phillips Certified Public Accountants & Advisors, said the diversification is largely driven by clients’ demands.

“Our business partners, in particular, want one-stop shopping.” he said. “For us it’s an opportunity to solidify relationships and make those relationships more sticky.”

DZH, with offices in San Francisco, Oakland, Burlingame and San Rafael, added a forensic accounting practice about three years ago and made acquisitions that gave the firm a new outsourced accounting services practice.

Offering more services is necessary, Wood said, with the heavy price competition that firms engage in for auditing clients.

“The audit market is a very competitive market,” he said. “Companies view it as a necessary evil, so they want the lowest-cost provider.”

The national accounting firm Marcum LLP added a specialized construction industry practice last year with its acquisition of DGLF CPA & Business Advisors, with offices in Nashville, Tenn., and Orlando, Fla. Marcum also acquired regional firms in Chicago and Philadelphia.

Philip Wilson, Marcum’s partner-in-charge of California, said the firm remains on the hunt for other specialized and regional practices. He notes that Marcum has offices in San Francisco and Southern California but does not have a presence in Silicon Valley.

Meanwhile, the addition of specialized services fulfills a purpose beyond diversifying revenue, Wilson said. It can also help feed the core auditing business with new clients.

“When a firm comes in and merges into Marcum, if they’re not doing public-company and SEC work, we can provide service with our other partners,” he said. “It’s really an opportunity to grow even faster organically.”

Branching out

Weary of the how-low-can-you-go price competition in their core auditing operations, accounting firms are seeking new services that offer better margins. Some of the most popular include:

Cybersecurity: Who better to help safeguard your financial information from outside snooping than the same firm that helps ensure that it's accurate?

Forensic accounting: Sifting through thousands of documents seeking wrongdoing used to be labor intensive, but computing power and accounting know-how can be a potent mix in sleuthing out white-collar crime.

Consulting: Big accounting firms had to exit the consulting business in the wake of Enron — but it's profitable, and they want back in.

Robotics: Picked up as part of 2011 acquisition, KPMG offers a "Robotic Process Automation" consulting service.