

Indiana CPA Society Case Competition 2004

You are Chris O'Donnell, the executive partner for O'Donnell & Rubenstein, preparing your presentation on the firm's growth strategy for fiscal year 2005, to be delivered at the firm's Annual Meeting, held in Hilton Head next week. This year's presentation is going to be the highlight of the Annual Meeting. Over the last year, the executive partner group has received a lot of static regarding the firm's strategy, or lack thereof, and morale at the partner level is nearing an all time low.

At the fiscal year 2004 Annual Meeting, the partner group decided to focus on building their private company practice. Due to uncertainty, the executive partner group could not estimate the impact that Sarbanes-Oxley, Section 404 would have on their practice. Because none of their public company clients (SEC registrants) met the requirements to be an accelerated filer, O'Donnell & Rubenstein decided to closely monitor what was happening in the profession and benefit from the experiences of others. Building their private company practice was exactly the opposite of their 2003 strategy which focused on building their public company practice to achieve economies of scale in their public company practice and build brand equity within the profession.

While you were putting the finishing touches on this presentation, you receive a call from Rubenstein, CEO, who said he was faxing you some articles he read online for your consideration (see Appendix D). He lets you decide how to incorporate this information into your presentation. The content of this presentation is, of course, subject to the final approval of the executive partner group.

Requirements

Using the information provided in the case, industry publications, news articles, and other information available, please compose Chris' firm growth strategy recommendation for O'Donnell and Rubenstein, addressing the following issues:

1. The strategic implications of a CPA firm identifying a client niche based on SEC registration status.
2. Firm's response and advice to current and prospective clients seeking to "go public" or "go private".
3. The effect of Sarbanes Oxley Section 404
 - a. Firm quality control policies
 - b. Firm culture
 - c. How will the Section 404 change your client relationships
 - d. The firm's "late mover" position in the Section 404 business line
4. The threat of additional changes in regulation (address in what area the changes are likely to occur and the resulting effect of those changes)
5. In the event of an oral presentation, be prepared to address the partners attending the 2005 Annual Meeting.

Case Format and Guidelines

The written case has no minimum or maximum page restrictions, so long as the above requirements have all been addressed. Each case should, however, contain a two- to five-page executive summary and any exhibits you plan to use to support your points.

APPENDIX A

Firm History

O'Donnell and Son, CPAs was formed in 1933 by Patrick O'Donnell, Sr., age 47, and his son Patrick O'Donnell, Jr., age 25. Their two man office was headquartered in Peoria, Illinois and the firm primarily provided tax and consulting services to farmers in central Illinois.

The firm grew in size and services and when O'Donnell, Sr. retired in 1967, the firm employed four CPAs and six support staff. While the majority of the firm's revenues continued to revolve around agricultural services, the firm entered the manufacturing industry, providing audit, tax, and consulting services in central Illinois.

Concerned that the firm had reached market saturation in both the manufacturing and agricultural industries, O'Donnell, Jr. identified two options for expansion in the spring of 1969. In order to grow, the firm either had to offer services to other industries or expand geographically. Cognizant of the time needed to establish the firm's name in other geographic markets, O'Donnell, Jr. quickly identified an additional industry within O'Donnell and Son, CPAs current market area, in order to use the existing brand equity. The industry identified was municipal utilities. Unfortunately, the firm did not have any industry experience in municipal utilities, so O'Donnell placed a "for hire" sign in the office window.

Meanwhile, O'Donnell, knowing geographic expansion was necessary, considered the firm's existing expertise (agriculture), and identified Des Moines, Iowa, with its agriculture driven economy, as an option. While doing some market research on the local competition, O'Donnell discovered Daniel Rubenstein CPAs, an accounting firm offering services to farmers and municipal utilities. It was a match made in heaven and the two firms merged to form O'Donnell & Rubenstein in the summer of 1970. O'Donnell & Rubenstein grew steadily throughout the 1970s, expanding to several other mid-western cities.

In 1983, one of O'Donnell & Rubenstein's long-time manufacturing clients successfully completed their initial public offering. As O'Donnell & Rubenstein was engaged by the company to complete their audit the following year, the firm started providing services to SEC registrants. Two years later, one of the firm's utility clients completed a public debt offering to finance capital projects needed to comply with EPA standards and the firm started providing services to their second public company.

By 2004 O'Donnell & Rubenstein's firm had expanded to include 8 offices (see Appendix C for listing), and their public practice continued to grow.

For a summary of FY2003 and projected FY2004 firm demographics, please see Appendix B.

APPENDIX B

FY2002 & FY2003 Results FY2004 Projections

	2002 (Actual)	2003 (Actual)	2004 (Projected)
Revenues (millions)	\$49.8 Million	\$60 Million	\$67.2 Million
Mix of revenues (by service line)			
Accounting and auditing	34%	35%	38%
Tax	33%	35%	31%
Consulting	33%	30%	31%
Mix of revenues (by industry)			
Agriculture	18%	16%	17%
Manufacturing	19%	20%	19%
Utility	57%	58%	60%
Other	6%	6%	4%
Mix of revenues (by client type)			
Public practice	13%	15%	13%
Private practice	87%	85%	87%
Gross Margin (by service line)			
Accounting and auditing	36%	33%	30%
Tax	34%	34%	33%
Consulting	35%	35%	36%
Gross Margin (by industry)			
Agriculture	31%	28%	27%
Manufacturing	40%	41%	40%
Utility	31%	32%	31%
Other	38%	35%	34%
Gross Margin (by client type)			
Public practice	33%	31%	31%
Private practice	37%	37%	35%
SEC Clients (by industry)			
Agriculture	1	1	1
Manufacturing	4	5	5
Software	1	1	1
Utility	2	3	3
SEC Client Revenue Breakdown (by service line)			
Accounting and auditing	56%	60%	64%
Tax	37%	35%	31%
Consulting	7%	5%	5%

APPENDIX C

2003 Office Locations & Headcount Distribution

Location	# of Professionals	# of Partners	# Public Clients	Gross Margin by Office
Chicago, IL	90	8	3	36%
Dayton, OH	20	2		35%
Des Moines, IA	75	7	2	33%
Detroit, MI	45	5	1	33%
Fort Wayne, IN	20	2		35%
Osh Gosh, WI	10	1		35%
Peoria, IL	92	11	2	32%
St. Paul, MN	40	5		33%
Total	392	41	8	

APPENDIX D

Sarbanes-Oxley Compliance Cost Estimates Soar Since January '04

AccountingWEB.com - *Aug-13-2004* - Complying with Section 404 of The Sarbanes-Oxley Act will cost public companies an average 62 percent more than previously anticipated, according to a recent survey by Financial Executives International (FEI), the leading professional organization serving Chief Financial Officers and other senior financial executives. The increase in Section 404 compliance costs stems from a 109 percent rise in internal costs, a 42 percent jump in external costs and a 40 percent increase in the fees charged by external auditors.

In July 2004, FEI surveyed 224 public companies with average revenues of \$2.5 billion to gauge Section 404 compliance cost estimates. Results showed the total cost of compliance is now estimated at \$3.14 million*, or 62% more than the \$1.93 million estimate identified in FEI's January 2004 survey. The companies surveyed expect to pay their auditors \$823,200 in fees for attestation of their internal controls, in addition to the annual audit fees. This compares to the \$590,100 companies expected auditors would charge for attestation in January 2004. The survey was conducted the week of July 19, and distributed to 3,088 companies, and drew a response rate of 13.8 percent.

"When we conducted our January survey, audit firms hadn't yet provided their clients with complete estimates for Section 404 work because the auditing standards had not been finalized," said Colleen Sayther, President and CEO of FEI. "Now that the standards are finalized and implementation efforts are further along, compliance costs can be more accurately determined."

As part of management's attestation process, the survey showed that companies are documenting internal controls for 92% of total revenue. The estimates on the cost of complying with Section 404, in terms of hours and dollars, have steadily risen over the last six months. Looking to the employee hours needed to be Section 404 compliant, public companies expect to spend an average of 25,667 internal hours (vs. 12,265 estimated in January) and 5,037 external hours (vs. 3,059). Companies also expect to spend an additional \$1,037,100 on software and IT consulting.

"Audit firms have been entrusted to deliver value from Section 404," adds FEI's Sayther. "They have latitude in terms of the scope and depth of their work and should exercise care and judgment, and be cognizant of the cost-to-benefit ratio. However, compliance alone cannot be expected to produce higher levels of accountability or deter those from acting without integrity. That responsibility remains in the hands of senior management entrusted to set a proper tone at the top and act in the best interests of shareholders."

Section 404 of Sarbanes-Oxley requires each company's annual report to contain (1) a statement of management's responsibility for establishing and maintaining an adequate

internal control structure and procedures for financial reporting; and (2) management's assessment, as of the end of the company's most recent fiscal year, of the effectiveness of the company's internal control structure and procedures for financial reporting. Section 404 also requires the company's auditor to attest to and report on management's assessment of the effectiveness of the company's internal controls and procedures for financial reporting, in accordance with standards established by the PCAOB (Public Company Accounting Oversight Board).

Survey Finds SOX Compliance Making Some Companies Consider Going Private

AccountingWEB.com - *May-21-2004* - The rising and unpredictable costs of complying with the Sarbanes-Oxley Act is causing some companies to consider going private to avoid being forced to adhere to the law's provisions, CFO.com reported.

What some had thought would be one-time costs are turning out to be accelerating costs, according to a study from Foley & Lardner, which found that 21 percent of the companies surveyed are considering going private.

Smaller companies are particularly struggling with compliance with 85 companies with annual revenue below \$1 billion (out of the 115 companies that responded to the survey), said the average cost of being a public company increased from \$1.24 million before Sarbanes-Oxley to \$2.13 million after.

"Not only do the costs associated with corporate governance reform continue to be significant," stressed the study, "but executives surveyed feel these costs are increasingly unpredictable."

The survey found that 60 percent of the respondents are not better able to predict these costs, which is why the number considering going private climbed from 13 percent last year to 21 percent this year.

Section 404 compliance was identified as having the largest financial significance for public companies, followed by legal expenses and D&O insurance, CFO.com reported.

While the costs increase for director fees accelerated last year, nonaudit fees paid to accountants dropped 20 percent from 2002 to 2003. The report said, "We believe this decline is primarily because certain consulting work done in prior years has been shifted away from the accountants because of Sarbanes-Oxley regulations, heightened sensitivity surrounding such work and the divestiture by large accounting firms of their consulting businesses."