

## Cutting CPA's role may invite audits

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As more businesses are hurt by the twin hammers of the weak economy and the tight credit market, some are talking about trying to shave their accounting bills, perhaps by moving down the ladder from getting audited financial statements to a review or even a compilation, say some certified public accountants.

Their reaction: Any short-term savings could easily be devoured by the increased exposure to employee fraud and other threats.

"In some cases, a company may have the ability to choose to downgrade" from an audit, said **Alan D. Sobel**, managing member of **Sobel & Co. LLC**, a Livingston-based accounting firm. "But third-party requirements may prevent it from doing so."

Companies that file with the Securities and Exchange Commission usually need to submit audited financial statements, he said, and banks also may require an audit for commercial borrowers.

"Back when the economy was hot, some banks relaxed their standards and did not require audited statements," Sobel said.

"But in today's environment, that's pretty rare. So if a company wants to take on or maintain debt, its lender may require audited financial statements."

In general, an independent audit calls for a CPA to judge whether or not a company's financial statements are presented in accordance with generally accepted accounting principles. Source documents will be examined, and third parties may be contacted to substantiate the legitimacy of transactions. The company's internal control procedures will be carefully evaluated and tested.

Because it is so thorough, an independent audit usually is expensive — but it offers the greatest comfort to banks, investors and others making decisions that depend on the audited financial statements.

One step below, and running at about a third of the price, is an accountant's review, which primarily consists of inquiry and some analysis. But a review generally does not involve an appraisal of internal control or third-party confirmation.

In a compilation, which may run half the cost of review, an accountant typically takes management's information and puts it together in a standard financial statement format. It provides no level of outside assurance.

For some companies — those owned by private equity groups — that's enough, said **Stuart Berger**, managing director at Clifton's **Sax Macy Fromm & Co. P.C.**, but "less scrutiny may lead to more opportunities for theft and fraud.

"In an effort to boost their returns, some companies, owned by private equity groups, have dropped from an audit to a compilation," he said. "We have some concerns about that, especially when it is accompanied by downsizing, which reduces the ability to segregate duties," like having one person collect and disburse cash while maintaining the records of cash activities.

At one time, it was not unusual for businesses to request an audit even if they were not required to, said **Anthony P. Rispoli**, the partner in charge of commercial audits at **Nisivoccia & Co. LLP**, a Mount Arlington-based CPA firm.

"Some companies had the requirement written into their original charter," he said. "In other cases, an owner that was no longer hands-on might have requested it as a way to check up on management."

But he said enhanced auditing requirements, such as the Sarbanes-Oxley Act of 2002, introduced after **Enron** and other accounting scandals, hiked the price and drove some companies to downgrade to a compilation or review.

"During the past few years, many of these 'audit by choice' companies dropped their audits," Rispoli said. "Many of the audits we do are for not-for-profit, government agencies and other business organizations that are required to have an audit, either by law or by their lenders."

But companies can take steps to reduce their audit bill, Sobel said.

"Start talking with the auditors well in advance, and ask what you can do to cut back on their [billable] work," he says. "We

would rather audit [or review] our clients' work, instead of creating schedules and analysis on our own."

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