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Increased Regulation Drives Demand For Forensic Accounting Services

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Major financial reforms and volatility following notorious frauds and scandals have led to outsized growth in the demand for forensic accounting services. During the past decade or so, Congress reacted to the WorldCom Inc. and Enron bankruptcies resulting from fraudulent financial reporting by passing the Sarbanes-Oxley Act of 2002, adding regulation targeting internal controls over financial reporting, among other requirements. The more recent financial crisis that is blamed for the Great Recession led Congress to pass the Dodd-Frank Wall Street Reform and Consumer Protection Act, requiring greater financial transparency of public companies. This increased regulation has contributed to strong revenue growth for forensic accounting services providers. A recent report by IBISWorld suggests that revenue from forensic accounting services provided by accounting firms has grown by 8.7 percent per year on average in the five years to 2013. It predicts a continued growth in forensic accounting services revenue of 6.7 percent per year on average in the next five years. This growth rate is still twice that for traditional accounting services.

The growth in forensic accounting services has been felt by accounting firms of different sizes. The Big 4 accounting firms lead the industry because of the diversified services they offer and the ability they have to mobilize the number of employees required to provide services at multiple locations simultaneously. However, the market for forensic accounting services still has a low level of market share concentration. This provides

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opportunities for mid-size and small accounting firms to provide a less costly alternative.

Even though revenue from forensic accounting services is only about five percent of the revenue for the overall accounting industry, experience shows that it has a unique advantage over the rest of the services provided by the accounting industry. As we saw during the recent financial crisis, the demand for forensic accounting services remained strong and contributed to revenue growth. During periods of crisis, demand for forensic accounting services grows to meet the increasing challenges. In contrast, demand for traditional accounting services dropped during the financial crisis as the number of companies demanding those services also declined. In 2009 and 2010, the number of businesses declined, leading to a corresponding decline in the accounting services industry overall. However, these business bankruptcies and restructurings caused an increase in demand for forensic accounting services, leading to a revenue growth rate that was more than four times that enjoyed by traditional accounting services.

The challenge, of course, is to consider how one should tap into the expected growth in forensic accounting services. As noted above, the lower average expected growth rate during the next five years compared to the last five years does not reflect a decline in the demand for forensic accounting services, but more likely reflects the likelihood that businesses and law firms will build these capabili-

ties internally instead of relying exclusively on third-party providers. The continued emphasis on corporate accountability will drive strong demand for such services.

The sustained demand is expected to come from three industries: finance, insurance and law. Ironically, these same industries drove the growth in forensic accounting services during the last decade while they were recovering from the financial crisis that affected them. For financial institutions, the anticipated increase in interest rates and the growing profitability of firms in this sector will provide additional challenges and financial resources to meet those challenges. For example, industry consolidation may provide additional opportunities for due diligence services in mergers and acquisitions.

There will be other consulting and auditing opportunities as well. In the insurance sector, continued opportunities for investigating insurance claims will support sustained growth. Investigations of insurance fraud claims and claims related to natural disasters such as hurricanes and other business interruption claims are expected to provide sustained growth and ample opportunities for those providing financial analyses and expert witness services. The unfolding rollout of the Patient Protection and Affordable Care Act may provide additional opportunities as well. Demand from law firms is also expected to grow, although at a much slower rate. Law firms, similar to accounting firms, were able to grow during the recession by balancing out the decline in corporate activity by taking advantage of the unique business disruptions brought on by the recession.

Low levels of market share concentration provide opportunities for accounting firms of all sizes to grow. Profit margins for forensic accounting services are typically greater than margins on traditional accounting services. That is not expected to change in the foreseeable future, but competitive price pressures will mount as more financial services firms, insurance companies and law firms continue to bring this service in-house.

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