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Producer Price Indexes for Services

**PPI for Legal Activity, Auditing
and Tax Consulting Services
in Germany**

Contacts:

Federal Statistical Office Germany

Astrid Stroh (astrid.stroh@destatis.de)

Susanne Lorenz (susanne.lorenz@destatis.de)

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1. Introduction

At the moment the project to construct producer price indices for the industry sectors mentioned above is still in pilot phase. It started in April 2003 and is supposed to end in the beginning of 2005. So the German producer price indices will be published regularly from 2005 on. The project takes place on behalf of EUROSTAT and is considered as European objective.

2. Description of the Sectors

Legal Activity Services

The actors of the legal services sector can be differentiated between lawyers, barristers and solicitors, notaries and patent attorneys. The lawyers, barristers and solicitors deal with advising clients in legal matters as well as disputes (consulting in non-forensic affairs, mediation) and their representation in court of law and other legal agencies. Most of the lawyers specialize in legal activity fields such as civil, commercial, criminal, family, fiscal, insurance, labor, renting, social, traffic law etc..

Notaries are responsible for stating legal situations in the field of family, company and real estate rights such as real estate contracts, partner inscription in company registers etc..

Patent attorneys accompany their clients from the invention, over the declaration of a patent for the innovative product or services, the protection of the product or services from competitors' patents until the prolongation of a patent.

The three groups differ in their education and skills: from notaries with the most profound education in law to patent attorney with a more technological and science background and less detailed knowledge in law.

The legal activity services sector is a relatively regulated market as the state has to keep law and order for its citizens. That is the reason why the legal activity services sector is very much structured according to country specific requirements. The systems of Central European countries such as Germany and France differ tremendously from the Anglo-Saxon legal systems. In Germany and France legal practice follows laws and acts whereas in Anglo-Saxon countries the jurisprudence is mainly focused on precedent cases. The degree of regulation is higher in these countries compared to the Anglo-Saxon countries.

Auditing and Tax Consulting Services

The auditors' occupation is to check and approve accounts and balance-sheets (for obligatory as well as for voluntary purposes), to evaluate a company's economic situation, as well as to assign the appropriate legal form of a company, offer tax and other management consultancy services.

Tax consultants deal with the tax preparation of the private household or business income, bookkeeping, payroll accounting and consultancy regarding all kinds of tax and business management questions and representation of clients' matters in front of the fiscal authorities.

Accounting consultants deal with bookkeeping and the preparation of accounts.

The tax consultant's and auditor's education is profound and requires long practical experiences in an office (legally regulated). The education and job admission for both, auditor and tax consultant, is strongly regulated in Germany as well as after the education there exist strict quality controls for the auditor's everyday works. The tax consultancy sector is similar to the legal activity sector strongly regulated and organized according to legal statutes.

In the contrary the auditing sector is free from price regulations but legally regulated referring to the auditor's output – e.g. balance sheets have to follow certain requirements regarding contents and formal standards¹.

3. Special Features of the German Market and Legal Fee System

Contrary to other countries, especially contrary to Anglo-Saxon legal systems, more than half of the fees that German lawyers charge their clients are calculated according to statutes especially set for lawyers and notaries by the legislative, so called scales of fee (since July 2004 Rechtsanwaltsvergütungsgesetz=RVG – formerly called Bundesrechtsanwaltsgebührenordnung=BRAGO; Kostenordnung für Notare). These fees do not leave room for any free price negotiations and the legal advisor has to stay exactly along the legal requirements so that the client is able to comprehend the price for the lawyer's performance at any time. If the client has no individual contract with the lawyer the lawyer has to follow these legal statutes.

Only in cases in which the client is willing to pay a lawyer's hourly rates or other kinds of fees settled after free price negotiations and only if the client has signed a written contract, the lawyer is allowed to charge more than the fees set by the statutes.

Another specialty of the German legal system is the fact that lawyers are not permitted to charge rates on success basis, which is usual in the Anglo-Saxon legal systems.

¹ As in Germany an obligatory rotation of auditing key aspects from year to year is legally regulated it is difficult to set standardized cases which is a requirement for price statistics.

Patent attorneys are not legally fixed in their pricing behavior. They usually bill hourly rates. At the moment price statistical evaluation of the patent attorneys is postponed because there are some difficulties to define standardized cases necessary for price statistics. The patent attorney usually accompanies the client and one's invention throughout its product life cycle. The attorney hardly differentiates between the phases of the life cycle which complicates the revelation of single services the attorney delivers. Without well defined services a price allocation to the services is not possible.

Compared to the legal advisors similar legal requirements have to be met generally by the German tax consultants. Here all bills concerning tax consulting activities have to follow the so called *Steuerberatergebührenordnung* (scale of fee for tax consultants)². The tax consultant charges on the basis of free price negotiations for non-tax consulting matters such as the execution of last wills or business management consultancy.

The auditors charge on the basis of free price negotiations for most cases. For them no legal fee restrictions are relevant. Only regarding quality and contents of their works the legislative sets strict rules. An auditor can account the bills on the basis of the *Steuerberatergebührenordnung* for those cases that apply to tax consultancy services.

Pricing behavior of the sector in % of the overall turnover

Nace	Scale of charge	Free price negotiations
74.11 Lawyers	60%	40%
74.11 Notaries	100 %	0%
74.11 Patent attorneys	0%	100%
74.12 Auditors	5 %	95 %
74.12 Tax consultants	85 %	15 %

Sources: DESTATIS survey March 2004, studies of the Institut für freie Berufe, Nürnberg, on behalf of the chambers

4. Index Methodology

4.1 Weighting Pattern

According to turnover, number of employees and the various activity fields in which the services of these sectors can be classified a weighting pattern is generated. This is the basis for further index calculations following the Laspeyre index.

As these sectors generally show constant quality of their products and services over time the weighting pattern stays stable and does not need to be revised often - in Germany a revision of weights is standard after five years.

- ² Contrary to the legal advisors the tax consultant who charges according to the fee scale is more flexible in setting the rates within given limits. The lawyer has no room at all regarding the definition of legal services and the corresponding fees.

4.2 Current Price Observation

As mentioned above (see paragraph 2) the German price system shows peculiarities that do not apply to other countries. Therefore, the price observation for these sectors has to follow a different methodological approach compared to Anglo-Saxon countries.

The following price systems are found:

A Scales of fee

Scales of fees that can be found in the Central European countries have their origin in the legislative and regulate the market prices. Here we find two kinds of fees which are relevant for the ppi construction: fix fees and *ad valorem* prices.

Fix fees

In the fee scales a certain amount of fee is listed that relates to a precisely defined legal or tax consulting service. They apply to standard and routine matters that do not require a detailed and elaborate occupation with the case and client (e.g. signature authentication or payroll accounting). The changes of fix fees that have to be revealed in order to calculate price indices are obviously easy to follow up.

2. *Ad valorem* prices

What is more difficult is the evaluation of price changes of fees that depend on the value of claim. This kind of fee represents the most important and most occurring share of turnover derived from the scales of fee. The amount of fee does not rise proportionally with growing values of claim. Here DESTATIS has decided to use standardized model cases that are classified according to the sector's activity fields and if possible according to the degree of difficulty of the tasks. The base model represents fictitious composite services (no real transactions) for which DESTATIS calculates prices in each period. These model cases are not always easy to define. It requires detailed and intensive analyses to find a solution as well as close contact to associations and chambers not to miss the experts' input.

For example: the tax declaration of non-corporate companies (generally regarding their turnover the smaller and middle-sized companies). Source for the determination of the value of claim is

the DESTATIS secondary statistics “Einkommenssteuer” (it includes the trade income tax). In Germany all data of trade income tax declarations that is collected by the national revenue is transmitted to DESTATIS - not neglected the data protection requirements. From this data average trade income levels and structures of German trade companies can be calculated. These will later serve to construct the price representatives that help to calculate the price indices.

As the changes in the values of claims of the various activity fields are extremely difficult to determine support indices have to be discovered such as housing price indices, income tax statistics or indices generated by the national account.

So the analysis of prices derived from scale fees do not have to be observed via direct inquiry but can be followed up by desk research and with the help of an elaborate model price system.

B Freely Contracted Fees

Freely contracted prices are either charge-out rates (more precisely: hourly rates) or flat rates.

Charge-out / Hourly Rates

The client pays an amount that equals the multiplication of a person day – usually eight hours - with the hourly rate. The rate itself can be negotiated between client and attorney or auditor. This kind of rate is used as methodological approach as detailed specified service outputs cannot be identified in consecutive periods.

Regarding the legal advisors it is of interest that the hourly rate is independent of the activity field. After a long education and intensive practical experiences on the job the more established experts expect a certain compensation for their work irrelevant of what tasks they have to fulfill for their clients.

Regarding the auditing services sector, however, there are differences between the price levels of hourly rates of the various activity fields

As law or auditing companies usually do not publish price lists of their hourly rates or services these rates have to be surveyed via direct inquiry. Many middle-sized and the big companies (regarding their turnover) compile a list of external commercial hourly rates for different staff levels. Smaller companies whenever they bring to account hourly rates (this is a question of market power and niche policy) have an average hourly rate for all employees dealing with the case (this is not the case in the auditing sector). Contrary to big companies the secretary or support staff is not billed separately but integrated in the general average rate. Regarding the auditing sector, nevertheless, also smaller auditing companies make a distinction in their accounting between the different hierarchy levels in their company.

Flat rates

Flat rates for a complete case for which time and the single service expenditures are not exactly calculated are also charged – referring to legal activities this occurs less often than in the Anglo-Saxon countries.

Contract pricing

Concerning auditing services this kind of accounting is popular for some cases as clients look for a solid base of calculation. However, one has to be aware of the fact that contract pricing is generally not permitted from the legal point of view as there would exist an interest collision with the quality of the work and auditing needs.

5. Sample Design

In order to gain further insight into the price structure of the free price market with no regulation of the German fee statutes direct inquiries of the relevant companies and respondents can be recommended. To get an overview over the structure of the market participants of the legal activity, tax consulting and auditing services sector the first step is to contact the chambers and relevant associations.

With the help of this information and DESTATIS-sources such as the so called *Dienstleistungsstatistik* – an official data base of all companies in Germany classified according to industry sector, turnover, number of employees and other important segment features – a random stratified sample is generated according to company size, turnover or employee figures. In Germany around 150 respondents for each sector – notaries, lawyers, tax consultants and auditors – were inquired to receive the relevant data to construct the weighting pattern. Out of these a panel for the current price observation for lawyers and auditors was generated which will regularly be inquired once a year. The reason that price observation only takes place every 12 months is that price changes hardly occur more often, on average every three to four years in a company, and it is of course a concern to minimize the respondent's burden. The other target groups mostly follow the official scales of fees. Therefore further inquiries are not necessary and the relevant information can be received via desk research.

Concerning increasing company size a total sample of all companies that represent the market leaders is inquired as they stay for the price drivers with dominant turnover figures.

Regarding the larger tax consultancy and auditing companies there is often an overlapping of the activity fields and it is sometimes hard to decide what the company's focus is in order to find the correct industry sector classification.

6. Price measurement tasks in the future

Productivity progress is a factor which influences the service and product quality. This question has to be discussed on an international basis, too.

In order to find the adequate methodology of price observation which goes in line with other OECD countries, helps to standardize the approaches on an international basis but does not neglect the peculiarities of the national markets a close contact to the price statistics experts abroad is necessary.

APPENDIX

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Overview over national methods legal activity services

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OPEN QUESTIONS TO BE DISCUSSED

In General

1. Concerning *ad valorem* prices it is sometimes hard to define the corresponding values of claims. In Germany statistics about the asset allocation among households, housing prices, and other important sources are hardly available or their construction still in pilot phases. How about other countries?
2. Do other countries integrate productivity progress figures into their producer price indices?

Industry sector specific questions – auditing sector

1. In Germany the point of time of price observation of auditing services is chosen according to the auditing and tax declaration terms. This helps to improve the response behaviour. Do other countries also pay attention to this fact?
2. Another question to be solved concerns handling of new contracts. This applies especially to the auditing services. In the legal sector the current price observation only puts focus on new contracts at the moment.