

University of Mississippi

eGrove

Guides, Handbooks and Manuals

American Institute of Certified Public Accountants (AICPA) Historical Collection

2003

Bill what you're worth

David W. Cottle

Follow this and additional works at: https://egrove.olemiss.edu/aicpa_guides



Part of the [Accounting Commons](#), and the [Taxation Commons](#)

Recommended Citation

Cottle, David W., "Bill what you're worth" (2003). *Guides, Handbooks and Manuals*. 625.
https://egrove.olemiss.edu/aicpa_guides/625

This Book is brought to you for free and open access by the American Institute of Certified Public Accountants (AICPA) Historical Collection at eGrove. It has been accepted for inclusion in Guides, Handbooks and Manuals by an authorized administrator of eGrove. For more information, please contact egrove@olemiss.edu.

The AICPA logo consists of the letters "AICPA" in a bold, sans-serif font, enclosed within a white oval shape that is set against a dark, rounded rectangular background.

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

BILL what you're **WORTH**

David W. Cottle, CPA, CMC

AICPA

BILL what you're **WORTH**

David W. Cottle, CPA, CMC

**Issued by the Management of an
Accounting Practice Committee**

NOTICE TO READERS

Bill What You're Worth does not represent an official position of the American Institute of Certified Public Accountants, and it is distributed with the understanding that the author and publisher are not rendering legal, accounting, or other professional services in this publication. If legal advice or other expert assistance is required, the services of a competent professional should be sought.

AICPA

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

BILL what you're WORTH

David W. Cottle, CPA, CMC

**Issued by the Management of an
Accounting Practice Committee**

Copyright © 2003 by David W. Cottle.

Published by
American Institute of Certified Public Accountants, Inc.
New York, NY 10036-8775

All rights reserved. For information about the procedure for requesting permission to copy any part of this work, please call the AICPA Copyright Permissions Hotline at (201) 938-3245. A Permissions Request Form for e-mailing requests is available at www.aicpa.org by clicking on the copyright notice on any page. Otherwise, requests should be written and mailed to the Permissions Department, AICPA, Harborside Financial Center, 201 Plaza Three, Jersey City, NJ 07311-3881.

1 2 3 4 5 6 7 8 9 0 PP 0 9 8 7 6 5 4 3

ISBN 0-87051-474-1

PREFACE

Pricing your services and billing for them is one of the most important skills in the successful practice of accountancy. However, formal university education almost never covers it; employee training seldom includes it; and even owners of the same firm rarely discuss pricing in an organized manner.

Apparently you should be born knowing how to set prices, negotiate prices, and submit invoices—or else learn by osmosis.

However, pricing and invoicing are like accounting or riding a bicycle: They are skills that one must *learn*. As a result, the skill levels manifested by owners, even in the same firm, often vary widely. Two owners in the same office with approximately the same experience, who handle the same types of clients, and do similar work often yield strikingly different results in invoicing clients.

The income you enjoy today and the kind of lifestyle you have when you retire depend on how well you manage your firm. This book will help you in this crucial management area. But, remember all CPAs must comply with both the AICPA Code and local state accountancy board regulations regarding fee arrangements. The AICPA rules may be found at <http://www.aicpa.org/about/code/ed302.htm> and <http://www.aicpa.org/about/code/ed503.htm>. Links for state jurisdictions may be found at <http://www.aicpa.org/states/info/index/htm>.



BENEFITS OF THIS BOOK

Follow the advice in this book and you can:

- Raise your standard chargeout rates if needed.
- Charge more for those engagements that justify a higher price.
- Learn the tools to implement specific value pricing ideas.
- Upgrade the profitability of serving marginal clients.
- Avoid price disputes and, if they occur, handle misunderstandings in a mutually agreeable and profitable manner.



HOW TO MAKE THIS BOOK AN INVESTMENT, NOT AN EXPENSE

Don't wait to finish reading the book to implement your ideas. Act immediately on the most relevant ideas you get. The sooner you act, the better you internalize new ideas and remember them.

Read other books, listen to audio cassettes, and watch videos on pricing and invoicing. You'll find a list of some of my favorites in the "Bibliography of Recommended Reading, Listening, and Viewing."

Expect results. Approach this book with a positive attitude. If you go to a department store, not everything in the store will interest you, but *something* in that store will interest you. Most books are the same way. This book is like a tool kit. Every job you undertake around your home does not require every tool in your kit. Sometimes you need only the needle-nosed pliers and a screwdriver. But it's nice to have that set of metric wrenches or star-head screwdrivers when the specific job that needs them comes along.

In this book you will find most of the pricing, invoicing, and negotiating tools you need to run a practice. No book could cover them all because the subject is too large.

To get the most from this book, take my ideas and tailor them to your situation. Keep a pen handy as you read. If something you read sparks an idea, write it down right then, before you forget it. Use the margin of the page if you have to. Ask yourself, How does this apply to *my* practice, *my* clients, and *my* situation? How can I make a few changes to this idea and make it work for us? Follow this advice and you will invest your time and not just spend it. Somewhere in this book, you will find a few really valuable ideas that will enhance your practice.

Take lots of notes in the margins. Keep writing. The more notes you take, the more value your book has for you in the future. People who take notes retain more of what they read. I hope you get a lot out of your investment in this book.

ACKNOWLEDGMENTS

I have had very few original ideas in my life—maybe a couple of dozen. So naturally that means a lot of concepts in this book originated with someone else.

I’ve done a lot of research for this book. I have studied the pricing of accounting, consulting, and advisory services since I first hung out my shingle in 1967. Although I am a pretty good biller now, I still learn new things all the time. This book represents the truth as I see it today, not the *Truth* with a capital *T*.

*Believe nothing, no matter where you read it, or who said it, no matter if
I have said it, unless it agrees with your own reason and your own
common sense.—Buddha*

It’s okay for you to be skeptical as you read this book. All I ask is that you test these concepts in your practice.

Lots of my ideas come from my clients. I have been privileged to work with about 25 of the 100 largest CPA firms in the United States, and about 15 of the largest 50 in the United Kingdom. Every big firm is a small firm that got it right. And I’ve worked with some extremely profitable small firms with less than ten total personnel, and learned from these boutique firms also.

Some of the concepts in this book were inspired by:

- *Value-Based Selling: The Art of Building High-Trust Client Relationships for Financial Advisors, Insurance Agents, and Investment Reps*, written by Bill Bachrach, and published by Aim High Publishing, San Diego in 1996
- *The 2001 Professional’s Guide to Value Pricing*, written by Ronald J. Baker, published by Aspen Law & Business in 2001, especially the material in Chapter 1, “Pricing Methods in the CPA Profession,” on pricing and risk and cost-driven rates versus target-driven rates and Chapter 10, “Get It In Writing,” on fixed-price agreements
- *Innovative Billing and Collection Methods That Work*, written by Charles B. Larson and Joseph W. Larson, published by Irwin Professional Publishing in 1995, especially the material in Chapter 4, “How to Set Prices,” on characteristics of engagements that deserve above standard pricing and in Chapter 7, “Seven Causes of Unplanned Write-downs and How to Avoid Them,” on taking the time to plan
- *Breaking the Paradigm: New Approaches to Pricing Accounting Services*, written by August J. Aquila, Ph.D., published by the American Institute of Certified Public Accountants in 1995

- *Million Dollar Consulting: The Professional's Guide to Growing a Practice*, written by Alan Weiss, published by McGraw-Hill in 2002, especially the demand and supply myth in Chapter 3, "The Pricing Myths"
- Paul Dunn of The Accountants Book Camp, especially the material in Chapter 1, "Pricing Methods in the CPA Profession," on pricing and risk; Chapter 4, "How to Set Prices," on packaging services; Chapter 5, "How to Discuss Prices with Clients," on the "Preferred client" approach; Chapter 10, "Get It In Writing," on fixed-priced agreements
- Dougherty, Littlewood & Hamilton, one of my clients, for material in Chapter 10, "Get It In Writing," on fixed-price agreements

Parts of this book were previously covered in earlier books of my own, namely, *Managing for Profitability: How Winning Professionals Earn What They're Worth* (David Cottle Consulting, 1993); *Managing by the Numbers—Monitoring Your Firm's Profitability* (AICPA, 1993); and *Target Marketing: How to Gain Profitable New Business* (Aspen Publishers, 2000).

I am especially indebted to L. Ron Hubbard, the twentieth-century American writer and philosopher, from whose works I have learned a great deal about human nature and motivations.

The following are members of the Management of an Accounting Practice Committee Task Force who provided direction for and reviews of this book.

August J. Aquila, Ph.D.
Consultant and Author
Minnetonka, Minnesota

David J. Sibits, CPA
Hausser + Taylor, LLP
Cleveland, Ohio

John B. Welch, CPA
Doshier, Pickens & Francis, P.C.
Amarillo, Texas

AICPA Staff:

Acquisitions: Laura Inge
Editor: Mary Mooney
Design: AICPA Creative Directions
Production: Steve Geske

TABLE OF CONTENTS

Introduction	1
	Once Upon a Time in the Ukraine	2
	Why Some Accountants Earn Much More Than Others	4
	Three Top Reasons Accountants Do Not Earn Enough	4
	A Word About Terminology	5
Chapter 1	Pricing Methods in the CPA Profession	7
	Cost-Driven Prices Versus Value-Driven Prices	8
	Pricing and Risk	9
	Cost-Driven Rates Versus Target-Driven Rates	9
	Investment Versus Value	10
Chapter 2	How Much Do You Really Earn?	13
	The Partnership and Generally Accepted Accounting Principles Problem	14
	The Financial Analyst’s Dilemma: Generally Accepted Accounting Principles Versus Economic Reality	16
	Analyze the Profile Firm	21
	The Key to Improving Profitability	22
Chapter 3	The Pricing Myths	35
Chapter 4	How to Set Prices	43
	Chargeable Time or Billable Time?	44
	Five Factors That Affect Your Prices	45
	When to Use Value Pricing	46
	When to Use Results Pricing	52
	When to Use Fixed-Price Agreements	53
	Packaging Your Services	54
	How to Raise Prices	55
	Unleash the Power of Unconditional Service Guarantees	57
Chapter 5	How To Discuss Prices With Clients	63
	Train Clients to Pay You Well and Promptly	64
	What “How Much Is This Going to Cost?” <i>Really</i> Means ..	64

	Turn a \$438 Sale Into a \$238 Sale . . . Without Really Trying . . .	67
	Do Not Make It Look Too Easy	69
	Your Pricing Communicates Your Value	70
	How to Use “Cottle’s Law” and “Cottle’s Corollary”	71
	The Problem With Price Estimates	72
	How to Avoid Professional Panic	73
	Ask for a Deposit	74
	Be Flexible	75
	The <i>Preferred Client</i> Approach	75
	Five Important Tools in Negotiating Prices	75
	How to Handle Price Objections	80
	How to Handle Procrastinators	80
	How to Handle Price Complaints	81
Chapter 6	Build a Better Firm With Better Clients	85
	Why Are You in Business Anyway?	85
	How to Recognize a Good Client	86
	Evaluate Clients Realistically	89
	Pick Your Five Worst Clients and Fire Them or Upgrade Them	91
	Fire the Least Profitable Clients	96
	Increase Your Minimum Individual Income Tax Price	97
	Raise Prices on Aggravating Clients to \$200 Above Standard	98
	Give your “Widows and Orphans” to Another Accountant	98
Chapter 7	Seven Causes of Unplanned Write-Downs and How to Avoid Them	105
	What Are Write-Downs Really?	105
	Cause 1: Estimating the Engagement Incorrectly (Miscalculating the Cost to Do the Job)	106
	Cause 2: Not Specifying Clearly What Is Included in the Price Estimate and What Is Not	109
	Cause 3: Inefficiency (Sometimes Laid at the Feet of the Employee’s Supervisor)	110
	Cause 4: Bad Scheduling	112

	Cause 5: Bad Supervision	113
	Cause 6: Inadequate Skill in Managing the Client Relationship	114
	Cause 7: Unwillingness by the Accountant to Confront the Client	115
Chapter 8	How to Set the Right Standard Chargeout Rates	125
	Why the 2-Percent Rule Is Dead	127
	Three-Step Formula for Setting Standard Chargeout Rate . . .	128
Chapter 9	Motivating Staff to Bill What They Are Worth	133
	Define Chargeable and Nonchargeable Time	134
	Use the 50-Minute Hour	135
	Adopt Daily Time Reporting	137
	Round Up, Not Down	137
	Use Peer Pressure	138
	Require Second-Owner Approval on Substandard Invoices . .	139
	Invoice Promptly	139
	Invoice Progressively	141
	Let Employees Draft Invoices	142
	Do Not Compromise on Prices	143
Chapter 10	Get It In Writing	155
	Engagement Letters	155
	Change Order	159
	Use the Invoice to Sell the Service	159
	Client Termination Letter	164
Glossary	173
Bibliography of Recommended Reading, Listening, and Viewing		177
	Books	177
	Audio Programs	177
	Video Programs	178
About the Author		179

*Personally I'm always ready to learn, although I do not
always like being taught.*
—Winston Churchill

INTRODUCTION

A group of accounting firms invited me to speak again at their annual meeting. They held the meeting in a resort location some two hours' drive from the airport, so one of the members picked me up. As we got on the freeway and she did not have to concentrate quite so hard on the traffic, she asked me, "What do you consider the number one problem facing accounting firms today?"

Wow! Tough question. Accounting firms face lots of problems. Some problems today are not the problems you faced a generation ago; some are. As the economy and the market change, so, too, do your challenges. Technology changes, competition changes, laws change, accounting principles change, taxes change. All these problems change with the times. So I had to think a long time to answer that question.

Then I realized that the people problems seem to remain the same year after year—partner compensation, recruiting, client relations, marketing, and so forth—because *people don't change*.

So the answer that I gave her years ago still is true today. And I think it will be true for many, many years.

KEY POINT: The number one problem facing accounting firms yesterday, today, and tomorrow is **attitude**.

Too many accountants have the wrong attitude about a number of things:

- They act as if they need their clients more than their clients need them.
- They have the attitude that they don't deserve to make a lot of money.
- They believe they have to justify everything they do.
- They have the attitude that something has to come hard to be worth anything.
- They think they have to work 60 or more hours a week during the busy season to be successful.
- They feel there is something immoral about charging more than their standard chargeout rates.

Here's the bad news—*As long as you have those attitudes, you will not be as financially successful as you deserve.*

Here's the good news—*You can change your attitude.* It's as simple—and as hard—as changing your mind. But changing your mind requires you to form new habits. Someone once said, "Bad habits are easy to form and hard to live with. Good habits are hard to form and easy to live with."

I sometimes think the most important thing I do for some clients is to get them to rethink the way they see themselves and their relationships with their clients.

This book will help you adjust your attitude.



ONCE UPON A TIME IN THE UKRAINE...

My wife's sister, Sheila, often vacations with us. She is always welcome because we all get along well and she speaks about six languages fluently. A few years ago, the three of us took a cruise down the Dnieper River from Kiev to Odessa.

At that time, the Ukrainian currency exchange rate was one United States dollar to 160,000 Ukrainian *coupons*. (As humor columnist Dave Barry says, I'm not making this up.) They had coupon currency in a lot of denominations, including 1,000,000; 500,000; 200,000; 100,000; 50,000; 20,000; 10,000; 5,000; and even 1,000 coupons (which equaled less than one cent).

One day our ship docked at Kremenchuk, an industrial city of one million people. It was market day, and all the tourists from the ship took a bus into town to visit the market. There were tables and booths scattered across a couple of square blocks where people sold everything from shoes to vegetables, beer to snacks.

Times were tough in the Ukraine. The same socialists who ruined the Soviet Union were still in charge and people really scraped to survive.

One old man, who stood about five feet, four inches tall, was behind a rickety table where he displayed what we thought were assorted pieces of scrap metal. When we looked closer it was odd metal bits such as nuts, bolts, angle iron, brackets, and what all. Judging from his three-day growth of grizzled beard and well-worn clothes, the old man scavenged in junkyards for odds and ends to sell at the market.

Sheila saw an unusual wrench on the table and thought it might make a memorable souvenir for a friend who collected hand tools. Sheila pointed to the wrench and spread her hands, palms up, in the universal gesture that means, "How much?"

The old man shyly looked up at Sheila (who is five feet, nine inches tall) and timidly held up two fingers with a questioning look on his craggy face. I read him to mean, "Is two okay?" Sheila looked at me. "Do you think that is 200,000 coupons or two dollars?" She didn't particularly care about the price; she just wanted to know what kind of currency to pull from her purse.

I shrugged. "I don't know. Why don't you ask?"

Sheila considered this communication problem a moment, and then held her left hand up like a piece of paper. She signaled with two fingers of her right hand and then used her index finger to draw a series of imaginary zeros on her left palm accompanied by a quizzical look.

The old man was pretty quick. He grinned and nodded his head. It was Ukrainian currency, not dollars.

Sheila pulled a 200,000-coupon bill from her purse and dropped it on the table.

The old man's eyebrows climbed toward his battered cloth hat, as he broke into a gap-toothed grin.

I could almost read his mind, thinking "She didn't even haggle! Has this crazy tourist never been to a market? I can't believe she took my first offer! Wait until I get home tonight and tell my wife; she'll never believe the sucker I found. Oh, wait a minute.... When I tell my wife, she'll yell at me for ripping off a guest in our country. I'll never hear the end of it." (I should tell you the Ukrainian people were invariably polite and among the most hospitable people I have known, and I have traveled to more countries than I can easily count.) He had obviously started with a ridiculously high (to him) asking price so he would have room to negotiate.

He felt so guilty at overcharging Sheila that he reached into a bag beneath the table and brought out a collapsible plastic drinking cup and handed that to Sheila along with the wrench. From this story, there are two important lessons.

KEY POINT: *The Law of Inverse Value*—The buyer of a product or service always values it higher than the seller.

Sheila really didn't care whether the wrench was 200,000 coupons (\$1.25) or \$2.00. It was totally immaterial to her how much she paid.

KEY POINT: *Corollary*—The seller of a product or service always values it lower than the buyer.

But it should not surprise you. Both parties to a transaction must receive more value than they give up; otherwise no transaction takes place (assuming no fraud or coercion).

The old man was deliriously happy to have Sheila take his first offer. He had expected her to bargain.

Now, as radio commentator Paul Harvey says, "... the rest of the story."

As Sheila put the wrench and cup in her shopping bag, the old man counted out 180,000 coupons in change!

His two fingers followed by a bunch of zeros was actually 20,000, not 200,000. He and Sheila had valued the wrench differently by a factor of ten!

From this, you can learn another important lesson.

KEY POINT: *Cottle's Observation*—Almost all buyers would pay more for the things they buy. Sometimes a lot more.

The same holds true for your clients. Every client that comes back each year thinks you are worth more than you charge. If they do not think that, they do not come back. The catch is that you don't know how much more they think you are worth. But most accountants never "push the envelope," to use the test pilots' expression.

As you read this book you will get lots of ideas on how to push the envelope and get your prices closer to what clients are willing to pay.

KEY POINT: All value is subjective. Goods and services have no inherent value. As my mother used to say, "A thing is only worth what people are willing to pay for it."



WHY SOME ACCOUNTANTS EARN MUCH MORE THAN OTHERS

When it comes to economic opportunity, the accounting profession is the proverbial *level playing field*. All the players have about the same education; they possess well above-average intelligence; it only takes a few thousand dollars of capital to start a practice; and most accountants practice in similar marketplaces with similar economic conditions. In other words, the profession truly has equal opportunity.

Then why do some accountants make so much more money than others?

- Is the accountant who makes \$400,000 a year twice as smart as one who makes \$200,000? Not likely.
- Does the \$400,000 accountant work twice as hard? No way!
- Has the \$400,000 accountant simply been in practice longer and thus have a head start? Sometimes, but not always.

Then what does account for the wide differences in financial performance between accountants?

KEY POINT: In a competitive marketplace, the quality and performance of management determines the ultimate success of the practice. Actually, in the long run, the only competitive advantage an accounting firm *can* have is the quality of its management.

A few firms thrive in today's volatile environment, firms that grow in depressed markets, firms that far outstrip their competition, firms that enhance both the quality and the quantity of their services to clients, while they earn appropriate—even amazing—profits.

You can do this, too. But you have to know what to do differently from what you have done in the past.



THREE TOP REASONS ACCOUNTANTS DO NOT EARN ENOUGH

Whenever I do a billing seminar or consult with a firm to improve profits, I invariably ask this question:

Disregarding what any of your fellow owners' chargeout rates may be, could you personally invoice and collect \$15 per hour more for your own time?

Over 50 percent of the time the answer is, *yes*. Often, 80 percent of the attendees at a seminar answer, *yes*.

What's your answer?

This question, and its answer, indicates the *number one cause of lack of profitability at accounting firms—we work too cheap*. And the really sad thing is that we *know* it.

Then I ask this question:

If I were to ask all the professionals in your firm, “What percent of the work you do could be done by someone with a lower chargeout rate, if you were better organized and if you had trained assistants available?” what would the average answer be?

The typical answers average between 35 and 70 percent.

What's your answer?

This question and its answer indicate the *number two cause of lack of profitability at accounting firms—we use expensive people to do low value work*. Another term for this is *systemic under-delegation*.

These two conditions are symptoms of the *third major cause of lack of profitability in our profession—we don't manage our practices like the businesses they are*.

In this book, I will address principally the first cause of low profits. I'll also give you a few ideas that may help in the other two areas.



A WORD ABOUT TERMINOLOGY

As accountants, we use many imprecise terms without even thinking about them.

For example, CPAs often use the words *chargeable* and *billable* interchangeably. We use *fee* and *price* interchangeably. And we use *bill* and *invoice* interchangeably. And sometimes, we use *bill* and *fee* to mean the same thing. Yet each of these terms can be different. *Charge* as a noun can mean “a debit entry to work in progress (WIP)” or “the price for a particular service or engagement.” *Billable* can mean “chargeable to the client's WIP” or “to be included in the client's invoice.” *Bill* as a verb can mean “debit it to the client's WIP” or “send the client an invoice.” Yet *bill* as a noun can mean “price” or “invoice.” *Fee* can mean “price” or “standard rate debited to WIP.” *Fees* can mean “sales” or “standard rates times chargeable hours.”

To avoid confusing the reader, this book uses more specific terminology:

- I avoid the word *billable* completely, using instead the word *chargeable*.
- I use *standard chargeout rate* in preference to *standard billing rate*.
- Whenever you read *fee* or *fees*, it means “standard chargeout rate(s) times chargeable hours.”

- I use *invoice* in preference to *bill*.
- I use *price* in preference to *fee* when referring to the amount that is invoiced to a client.

The “Glossary” includes definitions of all terms that might be confusing. Words contained in the Glossary are bolded the first time they appear in the text of this book.

CHAPTER 1: PRICING METHODS IN THE CPA PROFESSION

There are many ways for certified public accountants (CPAs) to price their services:¹

- Cost-plus pricing
- Fixed pricing
- Results pricing
- Value pricing
- Combinations of the above

Variations of *cost-plus* pricing are the most common in the profession. The CPA firm starts with their direct labor costs, adds an overhead factor and a profit factor, and assigns **standard chargeout rates** to each person in the firm based on their hourly pay. **Owner** rates are set subjectively somewhat higher than the rates of the most experienced employees.

Fixed-price agreements are contracts to provide specific services to clients for a fixed price, regardless of the time required to perform them. These are often used for pricing bundles of related services such as bookkeeping, financial statements, and tax returns for a single client.

Results pricing is the practice of agreeing with the client *in advance* to charge based on the results you obtain, regardless of the amount of time involved. Commissions and contingent prices are examples of results pricing.

In **value pricing**, the price may not be set until after the engagement is finished in order to evaluate the CPA's contribution and invoice accordingly. Most CPAs have done this—at least when evaluating their contribution *downward*—for many years.

These four pricing methods are not mutually exclusive. Most CPAs have always used hybrids of these methods, often without realizing it.

There are several concepts that can help you price your services effectively. These concepts include cost-driven prices versus value-driven prices, pricing and risk, cost-driven rates versus target-driven rates, and investment versus value.

¹ All CPAs must comply with both the AICPA Code and local state accountancy board regulations regarding fee arrangements. The AICPA rules may be found at <http://www.aicpa.org/about/code/ed302.htm> and <http://www.aicpa.org/about/code/ed503.htm>. Links for state jurisdictions may be found at <http://www.aicpa.org/states/info/index/htm>.



COST-DRIVEN PRICES VERSUS VALUE-DRIVEN PRICES

Most accountants determine prices by multiplying the time spent by various persons in the practice times a **chargeout rate** for each person or for that type of service. Note that some accountants charge by the day. In this book, all chargeout rates refer to hourly rates. (In the “Glossary,” also see *effective chargeout rate* and *standard chargeout rate*.) These accountants set their chargeout rates by referring to the salary and **overhead** costs for personnel who perform the engagement plus a desired profit margin.

Example: A common practice in many firms is to set chargeout rates at three times salary cost, based on the assumption that the typical firm’s operations should be “one-third salaries, one-third overhead, and one-third profit.”

We refer to these types of prices as *cost driven* because the amount of cost incurred performing an engagement directly affects the amount invoiced to the client.

Other CPAs base their prices on the value of the results obtained rather than on the costs involved to perform the service.

Example: If the result is disappointing, the CPA will take a **write-down** or sometimes no fee at all, regardless of the amount of cost he or she invested in the engagement. If the results are very good, the CPA will invoice the client more than **standard fees**.

We call these prices *value driven*, and they are common in other professions such as agency, brokerage, health care, optometry, and public insurance adjusting. The CPA profession has some cost-driven prices and some value-driven prices, with a predominance of cost-driven prices.

Example: A corporate law firm is predominantly cost driven for routine work for regular clients, basing prices on the amount of time required by the particular personnel at their individual chargeout rates. However, for closing a major transaction or handling an estate, it might base its price on a percentage of the amount involved and would thus be value driven.

Example: A personal injury law firm’s prices are mostly value driven, based on a percentage of amounts collected for clients. But the firm might also charge clients for copies, travel, court reporters, and the like, based on the costs incurred.

Example: A real estate agent bases his or her charges on the price at which a piece of property sells. But certain types of listings might also provide for the reimbursement of advertising and other costs or a fixed price for facilitating a transaction.

Example: A surgeon’s prices are primarily value driven, based on the nature of the surgical procedure performed. But X-ray or CAT-scan prices are highly affected by the cost involved, including labor.

Example: An accountant’s price to prepare a routine financial statement is based principally on the time involved. But the price to represent a client in a dispute with tax authorities could be based on the amount of taxes saved.

The overwhelming majority of accounting practices record all time charges to clients as **work-in-progress (WIP)** at an amount based on standard chargeout rates for each person. When engagements are completed and invoiced, any difference between the standard fee amount and the final amount invoiced is recognized as a **write-down** or **write-up**. Value-driven professions usually record revenue only if they send invoices to clients.



PRICING AND RISK

Cost-plus pricing transfers risk to the client. This cuts both ways. Although accountants prefer to have clients take the risk for the job going over budget or for unforeseen engagement problems (which is what cost-plus pricing does), clients prefer the accountants take the risk. After all, accountants are the professionals and they should know what they are doing. Profit comes from risk. No risk, no reward.

In return for the client assuming the risk, the accountant pays a reverse risk premium to the client by agreeing to accept only the standard rate. This puts a comfortable floor beneath the CPA, but it also creates an artificial ceiling. This is manifested in national averages of CPAs realizing around 90 to 95 percent of standard.

When you transfer risk to your clients, they will limit your rewards. That's only fair. If you adopt value pricing, you assume more risk, but you expect greater rewards. That's fair, too.

Just as cost-plus pricing transfers risk to the client, fixed-price agreements and, to various degrees, other value-driven pricing transfers risk to the accountant. Traditionally, accountants have preferred for clients to take the risk for unforeseen engagement problems (which is what cost-plus pricing does). Today, many clients prefer that their accountants take the risk.

In return for assuming the risk, the accountant charges a risk premium to the client by pricing at above standard rates. The client gains a comfortable ceiling on price.



COST-DRIVEN RATES VERSUS TARGET-DRIVEN RATES

An eastern firm has net sales of 99 percent of its standard fees. A western firm has net sales of only 82 percent of its standard fees. Is the eastern firm better managed? No, because the western firm's partners earn twice as much as the eastern firm's. Why? Because the western firm set its standard chargeout rates 50 percent higher than those of the eastern firm, so even though its write-downs appear excessive, its **effective chargeout rates** are significantly higher than those of the eastern firm.

At one extreme are firms that set optimistic, *best-case* standard chargeout rates. These firms base their chargeout rates on their highest value services. For most routine mandatory services, these firms would not expect to realize best-case rates because the market for such services will not support the higher rates. They plan for substantial write-downs (sometimes as high as 20 to 25 percent) over the course of a year. Such write-downs represent

pricing decisions they anticipate in client negotiations for routine services before an engagement begins. Net sales (amounts invoiced) represent the true production of these firms, because that is what the firms expect to earn before doing the work, and they are the benchmark by which the firms judge their management effectiveness. We refer to this ambitious pricing philosophy as *target driven*—the standard rates are the ideal scene they aim for, knowing that they will not achieve their ideal in every case.

Example: The western firm mentioned earlier whose net sales are 82 percent of standard is clearly a *target-driven* firm.

A number of target-driven firms are even more extreme than the western firm. They interpret the target-driven pricing philosophy by setting their standard chargeout rates far higher than other firms—for example, using a four to five billing multiple as compared to a multiple of three or three-and-a-half. These target-driven firms rarely expect to get standard rates. They consider their chargeout rates as representing the amount of value they *could* deliver if they hit a “home run” for the client—if they worked at their highest professional level on valuable services for clients that could afford that level of service and then achieved a dramatic result. In fact, home-run firms are often satisfied to get 50 to 75 percent of their higher standards. They may quote routine engagements for 65 percent of standard rates. Home-run firms use write-downs as a factor in pricing rather than in efficiently managing the engagement.

Most CPA firms (particularly smaller firms) set their standard chargeout rates assuming that they will invoice normal engagements at near-standard fees and that any write-ups and write-downs will be exceptional. These firms do not anticipate write-downs in price negotiations, and write-downs clearly indicate their cost management skills. Standard fees reflect the true production of these firms because they represent what the firms expected to invoice before doing the work, and they are the benchmark by which the firms will judge their management results. We refer to this moderate pricing philosophy as *cost driven*.

Example: The eastern firm whose net sales were 99 percent of standard was clearly a cost-driven firm.

Most firms fall somewhere between these two extremes. Generally, the larger the firm, the more likely it will use ambitious, target-driven chargeout rates.

Regardless of which position you take on setting standard chargeout rates, the use of write-downs is an indicator of client management skill.



INVESTMENT VERSUS VALUE

Compare the following terms, and consider the contrasts:

Cost	—	Benefit
Effort	—	Results
Input	—	Output
Investment	—	Return on investment

Consider the first line in the above table. In every personal and economic activity you pursue, you think that the *benefit* of doing something will exceed the cost. Whether it is having a child or going to college, you estimate that the benefit will exceed the cost (including time, money, and inconvenience).

Consider the second line. In everything one does in life, one expects the *results* will exceed the *effort*; else why do it? This applies to the undertakings in one's personal life, like going on a diet or quitting smoking, as well as business activities.

Look at the third line. In every business activity, the *output* must exceed the *input* or the venture is uneconomic. The old Soviet socialist system liquidated the infrastructure left over from the Czars over a 70-year period. Each year, the output of the system was less than the inputs until it collapsed.

And look at the fourth line. Whenever one invests, one expects a return *on* the investment and a return *of* the investment.

The left side of the table represents *activities*; the right side is the *outcomes*.

- Which side of the table does a time-keeping system measure? That's right, it measures the left, the *activities* performed.
- And which side of the table do clients care about? They care about the right, the *outcomes* that CPAs obtain for them.

All *activities* exist within the CPA firm. They may not even be visible to clients. In fact, they are often invisible. All *outcomes* are valued by the client and such outcomes exist externally to the CPA firm.

A time system measures the cost, effort, and so forth, that a CPA *invests* in an engagement. But clients care principally about the right side. They care about their benefit, the results they obtain, the *value* of the service to them.

There is a myth that the amount on a CPA's time-keeping system indicates the fair price. The reality is that the amount on a time-keeping system only indicates what the firm invested in an engagement at standard rates. It has little or nothing to do with the value of the work.

Often, accountants get caught up in their costs in the job because cost measurement is what they do. They often ignore what clients really care about—value—because value is subjective and difficult to measure.

Cost-plus pricing creates an inevitable conflict of interest with clients. Cost-plus pricing means increasing the client's costs to increase profits. In 12 years of accounting practice and over 20 years as a profitability adviser, I have never seen a CPA firm stretch their hours to make more money. Nevertheless, clients sometimes believe there is a risk their accountants will do so.

With today's emphasis on downsizing, reengineering, and doing more with less, cost-plus pricing is the exact opposite of efficiency.

By making hours important, you encourage the client to focus on hours instead of results. The myth that value is created from labor was popularized by Karl Marx. He called it the *labor theory of value*. It is ironic that so many accountants subscribe to this bedrock theory of socialism.

The alternate theory (on which capitalism is based) is the *subjective theory of value*, which holds that goods have no inherent value, only what people are willing to pay for them.

But by charging a standard chargeout rate several times higher than your client makes per hour, you force them to focus on your hours.

If your clients focus on hours, they constantly try to figure whether they can afford you and ignore the value you provide. The multidimensional value you create is turned, like gold into lead, into a one-dimensional, commoditized, easily compared price.

Cost-plus pricing focuses on efforts, not results.

Cost-plus pricing doesn't reward creativity and innovation; it rewards inexperience and inefficiency, even incompetence.

After the Persian Gulf War, when the Kuwaiti oil fields were on fire, the "experts" agreed it would take six months or more to put out the fires. Red Adair and others put them out in three months. Do you think they charged by the hour?

What would have been the result if Red Adair had charged by the hour? Those oil fields might be burning still.

You don't hire a gunfighter and pay him by the bullet.

—Anonymous

Cost-plus pricing has its advantages. It's easy to explain to clients. It's easy to administer. It's easy to defend. And it is a great cost-accounting tool.

Cost-plus pricing encourages people to work harder, not smarter, by reducing incentives to creatively increase productivity. It penalizes investments in technology. Many CPA firms in the 1980s and 1990s hesitated to invest in computer systems to mechanize the production of tax returns and financial statements because they were afraid their revenues would decline because of the decrease in chargeable hours. Cost-plus pricing encourages the hoarding of hours and discourages delegation.

Any time you use cost-plus pricing, you will have write-downs.

CHAPTER 2

HOW MUCH DO YOU REALLY EARN?

Many certified public accountants (CPAs) go into public practice believing they can earn more than they will working for someone else. Unfortunately, a lot of CPAs never figure out whether they actually achieve their goal. The difference between earning a salary and owning a business is that if you own a business, you should make a profit on your investment *in addition* to what your salary would be if someone else owned the business. Many firms that think they make big profits really do not—they do a little better or a little worse than working on salary. Financial statements will not show this unless they are properly analyzed.

The points made in this chapter are illustrated with one of the profile firms selected from the American Institute of Certified Public Accountants' (AICPA's) *Management of an Accounting Practice Handbook*, a publication familiar to most readers.

In constructing the hypothetical profiles, the AICPA did not intend to show a perfect firm. The *MAP Handbook* states:

If all accounting practices were rated on a scale of one to ten, with ten being the perfect practice, the profile firms might be an eight. Also, a significant amount of judgment was exercised in constructing the profiles. They are not arithmetic averages of the various sources of financial data. There are inconsistencies in transition from firm profiles. As firms create more partners, the statistics may be distorted as a partner may have been a manager the previous year and the compensation for the partner is slightly higher than a manager.¹

The profile firm selected is the middle firm of the five different-sized profile firms presented in the 2002 edition of the *MAP Handbook*. It has three owners, 14 **technical staff**, and 3.5 **full-time equivalent (FTE) support personnel** for a total of 21.5 people who generate \$1,882,300 of **net sales**. Note that some of the terminology in the *MAP Handbook* has been changed to conform to the terminology used in this book. For more information, see the “Glossary.”

Exhibit 2-1, “Sample Profile Firm Income Statement,” and Exhibit 2-2, “Sample Profile Firm Balance Sheet,” are summaries of its income statement and balance sheet with a column for you to enter your firm’s figures. Exhibit 2-3, “Sample Profile Firm Analysis of Fees,” shows where the profile firm’s net sales came from.

Notice that the audit owner’s rate is only \$10 per hour more than a manager with six years of experience. The tax and executive/MCS owners charge out at only \$125 and \$150, respectively. The average owner’s chargeout rate of \$123.08 is 2.24 times the \$55 rate of

¹ Serotta, Abram. “Profile Firms,” Chapter 504 of the *Management of an Accounting Practice Handbook*. New York: American Institute of Certified Public Accountants, 2002, Chapter 504/page1.

an inexperienced staff employee. Typically, the average owner rate in a normally structured firm would be three to four times the rate of a new staff employee.

This would indicate that the average owner rate of the profile firm should be \$165 to \$220 per hour.

This chapter will point out how traditional financial ratios can be misleading when comparing firms' profitability and outlines a method to determine a firm's economic income.



THE PARTNERSHIP AND GENERALLY ACCEPTED ACCOUNTING PRINCIPLES PROBLEM

One quirk of proprietorship and partnership financial reports is that they reflect all owners' compensation as profits, which is correct under **generally accepted accounting principles (GAAP)**, but can nevertheless be misleading. For example, some years ago a good friend and client asked me, "What is a normal profit margin in my city? I think my profit margin is too low."

I asked whether five CPA employees still worked for the firm. When he said *yes*, I gave him an answer that he did not expect. "You can raise your profit margin if you make partners out of your employees. Eliminating their salaries reduces expenses by the amount of their salaries; your profit margin will increase."

My friend commented, "But that won't make *me* any more money."

To which I responded, "Precisely!"

That was the point I wanted to make.

KEY POINT: Profit margin on a partnership income statement is pointless for evaluating different firms or even the same firm from year to year if they have different ratios of employees to owners.

The Ratio of Employees to Owners

As my friend knew, if you promote an employee to owner, his or her former compensation may or may not increase. But the amount of the new owner's former salary miraculously disappears from expenses and amazingly transforms into net income. Has the firm really become more profitable just because its profit margin rose? Of course not; it's just a quirk of partnership financial reports that owners' compensation is reported as profits.

That is why the so-called profit margin isn't a good yardstick to measure your financial performance. You need to reflect owner compensation costs at fair-market value before you can compare your firm to another firm with different **leverage**.

You might think that, even if you cannot make a meaningful comparison to other firms, you can use profit margin to watch trends for your own firm and compare your own results from year to year.

But look at the profile firm. Right now, it shows a margin of 38 percent. If they promote their manager to partner *with no change in underlying compensation and no other change in the performance of the firm*, expenses decrease by the manager's \$55,000 salary, nominal "profit" increases by \$55,000 to \$768,800, and "profit margin" increases to 41 percent, an improvement of about 7 percent in the firm's profit margin. At the same time, net income per owner declines by 19 percent from \$237,933 to only \$192,200. That is why profit margin can mislead the reader who makes year-to-year comparisons.

KEY POINT: Neither net income per owner nor profit margin is a meaningful figure when comparing two firms with different leverage, or the same firm from year-to-year.

The Salaries of Owners

The situation is no better for incorporated practices. Some firms show officers' or owners' salaries while others do not. And the salaries they do show may or may not reflect economic reality.

Example: One firm gives owners equal nominal monthly draws and distributes unequal profits quarterly. The monthly draws are shown on the income statement as owners' salaries and the quarterly distributions are shown as a distribution of capital. Most managers of the firm earn higher salaries than these nominal monthly draws, so these "salaries" do not reflect economic reality.

Example: One professional corporation drew out all profits as salaries for the owners. The president (managing owner) drew a salary of over \$400,000 annually. But this salary did not reflect economic reality since his chargeout rate was only \$200 per hour. Other owners were also highly compensated.

Whether the firm is a partnership or corporation, some owners call all profits *salaries* or *bonuses* or otherwise, depending on the applicable tax law, and show them as an expense on the income statement. Some firms call all owners' compensation *draws*, deduct it from the capital accounts, and do not show any owners' compensation as an expense.

You must adjust profits to reflect the economic reality of owners' compensation before you can compare your firm to a firm with a different owner compensation method or a different ratio of employees to owners.

Interest on Owners' Capital

Some firms pay interest on owners' capital and show it as an expense just like the interest paid to a bank. Others lump the owners' interest with other profit distributions from the capital account. And those firms that do record interest on owners' capital may not use a fair-market interest rate.

One of my clients has paid 10-percent interest on owners' capital for many years—regardless of the prime rate, which could be anywhere between 5 percent and 15 percent. I recently spoke with a small firm that paid owners 6 percent interest on their capital.

Once again, you must adjust profits to make different firms' cost of capital equal before you can meaningfully compare firms with different capital structures.

Pricing Philosophy

Earlier, I mentioned the eastern firm whose net sales were 99 percent of standard fees and the western firm whose net sales were only 82 percent of standard. They had different pricing philosophies because the western firm's billing multiples were 50 percent higher than those of the eastern firm.

Consequently, **realization** or write-downs must also be adjusted as a profit indicator to reflect different pricing and market positions before it is possible to compare firms with different pricing philosophies.



THE FINANCIAL ANALYST'S DILEMMA: GENERALLY ACCEPTED ACCOUNTING PRINCIPLES VERSUS ECONOMIC REALITY

The preceding discussion illustrates that accounting firms can differ in the ratio of employees to owners, method of compensating owners, capital structure, and pricing philosophy. Partnership accounting (which shows owners' compensation as profits whether it came from invested capital, labor, or entrepreneurial skill) exacerbates those differences. It is often futile to compare different firms' salaries, chargeout rates, or other operating information because it amounts to comparing "three grapes with four melons."

Fortunately, Ron Weiner, president of Perelson Weiner CPAs in New York City, developed a way to take these different factors and convert them to a common model so that the results from different firms can be compared. Weiner noticed that most firms establish their standard chargeout rates based upon a multiplier of employee salary. He used this fact to establish a standard pricing and cost system, which can be used to compare the results among firms.

The three steps to convert a firm's financial information into a common model are outlined in the following sections.

Step 1: Convert Owners' Salaries to Fair-Market Value

Let's distinguish between owners' *salaries* and owners' *profits*. Every owner, like every other person who works for the firm, deserves payment for services provided. For employees, it is easy to see that the value of their services to the firm is negotiated at arm's length and directly relates to each person's chargeout rate.

Example: Paul Professional, a sole practitioner with several employees, set his employee chargeout rates by this method:

Employee's base annual compensation	\$36,000
Divided by estimated chargeable hours	<u>1,800</u>
Equals cost per chargeable hour	\$ 20.00
Times billing multiple	X <u>3</u>
Equals standard chargeout rate	<u>\$ 60.00</u>

This is the old *2-percent rule*. \$60 is 2 percent of the employee's \$3,000 monthly base pay. In Paul Professional's case, if you divide the \$60 chargeout rate by the \$36,000 annual compensation, you get an *annual* billing multiple of .001667.

If you asked Paul about his method, he would answer that he uses a *three-times billing multiple* and divides his employee's salary by 1,800 chargeable hours before multiplying by 3. Other firms use different methods.

Example: A larger firm sets employee chargeout rates as follows:

Salary	\$36,000
Divided by estimated chargeable hours	<u>1,600</u>
Equals cost per chargeable hour	\$ 22.50
Times billing multiple	X <u>3</u>
Equals target rate	<u>\$ 67.50</u>
Actual chargeout rate used	<u>\$ 70.00</u>

Dividing the \$70 rate by the \$36,000 annual compensation yields an actual billing multiple of .001944.

This firm, like Paul Professional, also uses a so-called *three-times billing multiple*, yet its annual multiple was 17 percent higher—.001944 compared to Paul's .001667. The difference is that the second firm is divided by 1,600 chargeable hours and rounded upwards, while Paul divided by 1,800.

KEY POINT: The practice of assuming different levels of chargeable hours makes it impossible to compare standard chargeout rates at different firms merely by asking, "What is your billing multiple?"

Some firms also use different multiples for employees at different levels. One firm uses lower multiples for its audit and tax managers (.001619 and .001640, respectively) than it does for its less-experienced employees (.001767 and .001719, respectively). The differences are about 9 percent for audit and 5 percent for tax.

But what about the owners? Does the value of their services to the firm also relate to their chargeout rates? Not always.

If you invert Paul Professional's chargeout rate formula for employees and divide Paul's own chargeout rate by his .001667 employee multiplier factor, you can approximate the fair-market value of Paul's compensation. Thus, if Paul's rate is \$150, divide that by

.001667 to get a fair-market salary of about \$90,000. That might, or might not, approximate the practice's replacement cost to hire Paul.

The profile firm financial information gives 2,250 total hours for each technical employee, and annual compensation includes overtime compensation. Most CPA firms base their standard chargeout rates on a multiple of base pay (at straight time rates). To calculate base pay, I assumed the 170 hours of overtime for each technical employee was paid at 150 percent of their regular rate.

Exhibit 2-4, "Sample Profile Firm Employee Billing Multiples Calculations," shows the billing multiples for the profile firm.

The profile firm has significantly lower multiples for support employees than for technical employees and higher multiples for new staff than for in-charges. If your firm has significantly different multiples for employees at different levels, then you should use the multiple in effect for your most experienced employees to calculate the fair-market value of owners' salaries.

For the profile firm, use .001853, the manager's multiple, shown in Exhibit 2-4.

Exhibit 2-5, "Sample Employee Billing Multiples Form," is a form to use in making the employee billing multiple calculations for a firm using employee chargeout rates and annual base compensation. For part-time employees, multiply their hourly compensation by 2,080 hours to figure the equivalent compensation for a full-time person.

Exhibit 2-6, "Sample Profile Firm Fair-Market Value of Owners' Salaries Calculations," shows the owners' salary calculations for the profile firm.

The profile firm's average owners' salaries calculate at \$66,422. This means that—based on their chargeout rates—they are telling the world that clients could hire people with the owners' level of experience for \$66,422 in the open market.

This seems low to me. In most areas of the United States, senior-level financial executives comparable to typical owners of CPA firms should command salaries of \$90,000 to \$100,000 or more. If so, then the profile firm's owner chargeout rates are too low, even based on their current billing multiple.

In Paul's case, inverting his \$150 chargeout rate yields a fair-market salary that approximates the replacement cost of his services, because he had about 10 years of experience at the time (early 1990s). But that is not always the case, especially with the profile firm.

Usually, expect a newly promoted owner to make about 30 percent more than he or she did as a manager. The profile firm's manager makes \$55,000, indicating that the audit owner should make at least \$71,500 if he or she is newly promoted. Assume \$71,500 as the fair-market value of the audit owner's salary. This would indicate a standard chargeout rate of \$132 using the firm's current billing multiple.

The tax owner's rate is 25 percent higher than the audit owner's, indicating a fair-market salary of \$89,375. The executive owner's rate is 50 percent higher, indicating a fair-market salary of \$107,250.

All other things being equal, a tax person's chargeout rate is 25 percent higher than an auditor's. Therefore, the present *ratio* of the profile firm's tax and audit owner rates is appropriate, except that the audit owner rate should be about \$132, which means that the tax owner should be charging out at \$165. And assuming the average owner rate should be \$165 to \$220 per hour (three to four times the rate for an inexperienced staff accountant), then the executive/MCS owner should be charging out at \$198, which would bring the average up to the minimum of \$165, or three times the rate for an inexperienced staff accountant.

Since this is an analysis of how much the owners currently earn, continue by using the actual chargeout rates and the fair-market salaries as compared to the manager, shown at the end of Exhibit 2-6 in the table, "Sample Fair-Market Salaries."

Exhibit 2-7, "Sample Fair-Market Value of Owners' Salaries Form," is a form you can use to make the owners' salary calculations for yourself and your fellow owners using your employee billing multiple and your and your fellow-owners' personal chargeout rates. If you, too, find the calculated salaries lower than the replacement cost in your area for owner-level accountants, use the fair-market value for your area.

Exhibit 2-6 shows that the first \$268,125 of so-called profit the firm earns is actually the economic cost of "hiring" their owners. Any additional income owners earn (or shortfall if income doesn't cover a fair salary) is dependent upon the effectiveness of their management and marketing efforts.

Step 2: Convert Owners' Capital to Financial Equivalents

A number of firms finance receivables or equipment with bank loans or leases while other firms have no debt. To compare these firms, you must impute an appropriate rate of interest on owners' capital. (Many firms keep their books on a cash basis for tax and financial reporting purposes. For economic analysis purposes, firms should use the accrual method, modified by not providing for deferred income taxes. I recommend not bothering with deferred income tax since most firms arrange their affairs so that income is taxed to the owners instead of the firm.) Since owners' capital is at greater risk than a creditor's loan, most firms impute an interest rate of more than the prime rate. Usually, 2 percent over prime or 125 percent of the prime rate is suggested. But because it is impossible to predict what interest rates will be by the time this book is published, a 10-percent interest has been used for simplicity.

Exhibit 2-8, "Sample Profile Firm Interest on Capital Calculation," shows the calculation for the profile firm with space for a firm. (If you don't know your average capital, use the averages of your capital today and twelve months ago.)

Step 3: Convert Net Sales to Standard Fees

Revenue results from *production* (doing the work) and *pricing* (charging the proper amount). Net income is revenues minus the costs to earn those revenues (*cost management*).

The majority of firms that use cost-driven chargeout rates can better measure their true production by standard fees than by net sales.

Ron Weiner defines the *product* of such firms as “\$1.00 of service measured at standard rates.”² This means that the revenue (in the sense of *production*) of the firm is really standard fees, and reductions from that figure—whatever the cause—are an operating cost.

Although this view of “revenue as standard fees” is not in accordance with GAAP, it is in accordance with good cost accounting procedures. You should employ this method of financial reporting only as an analytical method to evaluate your operations. Naturally, you do not use this method for externally presented financial statements.

If you don't know your standard fees, you can estimate them by working backward from an estimate of your percentage write-downs.

Example: Elizabeth Expert knows she invoiced \$386,412 last year. She doesn't know exactly what her write-downs were, but thinks they were about 12 percent. If so, then her \$386,412 net sales is 88 percent (100 minus 12) of her standard fees. Divide \$386,412 by .88 to give estimated standard fees of \$439,105. Subtract \$386,412 from \$439,105 to get write-downs of \$52,693. As a check, \$439,105 times 12 percent agrees with \$52,693.

You can also start with net sales and add back an estimate of the dollar amount of write-downs. Either way, you must have at least a “guesstimate” of write-downs to complete the remainder of the analysis.

Exhibit 2-9, “Sample Profile Firm Standard Fees Calculation,” shows the calculation for the profile firm with space for your firm.

Weiner concludes:

By adding allowances for partners' salaries and interest on capital to firm costs and expenses, all costs can be made comparable. Expressing these costs as a percentage of standard time charges yields the cost to produce \$1.00 of service. To the extent technical salaries vary from one-third of standard time charges, it can only be due to the pricing structure or productivity as measured in chargeable hours. Also, to the extent other costs (exclusive of technical salaries) vary, it constitutes a deviation in the overhead rate which can then be compared against other firms and periods. *To the extent you cannot bill and collect your standard time charges, this should be viewed as a bottom line cost and not included in overhead since it costs the same to provide a dollar's worth of service whether you collect it or not. [Emphasis supplied]*³

True profit is the amount left over after properly allowing for the value of owners' salaries and interest. This economic income is actually the owners' returns for their abilities at managing and marketing the practice, or—as Weiner refers to it—the “entrepreneurial results.”

² Ronald Weiner, “One-Third Labor, One-Third Overhead: What Happened to One-Third Profit?” presented at the 1989 AICPA National Practice Management Conference East in Atlanta, Georgia.

³ *Ibid.*



ANALYZE THE PROFILE FIRM

With owners' salaries, interest, and standard fees calculated, it is possible to compare the operations of any firms. So, let's evaluate the profile firm using the Weiner method. Exhibit 2-10, "Sample Profile Firm Analysis," shows the calculations for the profile firm with space for your firm.

Note that the Weiner model expresses profits (*economic income*) as a percent of standard fees. GAAP accounting expresses profits as a percent of net sales. As a result, the revenue denominator for percentage calculations for the Weiner model is different from traditional partnership accounting. The profile firm's *profit margin* shown the traditional way was 38 percent. After allowing for owners' salaries and interest, their entrepreneurial results (true economic income) was only 21 percent.

If the profile firm operated on a true one-third salaries, one-third overhead, and one-third profit model, the operating cost figure on line 15 would be 67 percent, and the profit percentage on both lines 17 and 21 would be 33.

Where did the profits go? The profile firm's total costs were 75 percent, 8 percent too high. Why? Either their **utilization** was too low or their prices (based on the effective chargeout rate) were too low. Which is it? That issue will be examined later. But one clue is that technical salaries shown on line 12c are 42 percent of standard fees, not 33 percent.

Line 16 shows that the profile firm earned \$484,925 before write-downs (25 percent of standard fees) and then lost 14 percent of its profit to write-downs (line 19).

Analyze Firm Overhead

The "one-third, one-third, one-third" paradigm assumes that overhead equals salary cost. Exhibit 2-11, "Sample Profile Firm Overhead Analysis," compares overhead and salaries of the profile firm. As you will note, overhead costs are 77.19 percent of salaries. Does the profile firm show excellent cost-management skill? Not necessarily. The *overhead equals salaries* paradigm is only an approximation; the relationship was never meant to be exact. But the profile firm could be skimping on marketing, training, facilities, or other operating areas. Variances in overhead ratios also arise from regional differences between cities, suburbs, and rural areas, for example.

Regardless of the overhead ratio, for analytical purposes, it is possible to combine salaries and overhead and say that they should be approximately two-thirds of revenue in a cost-driven firm. If owner and other technical personnel salaries and overhead vary from two-thirds of standard fees in a cost-driven firm, it can only be due to:

1. The pricing structure (they use the wrong chargeout rates);
2. Productivity (they do not achieve enough chargeable hours); or
3. Excessive write-downs (They have people who commit chargeable hours to work at too low a value.)

Analyze Firm Write-Downs

According to Weiner, firms that offset write-downs against standard fees and record net sales as their revenue should gross up revenue to standard by adding write-downs back to net sales. Then, show write-downs as a separate line item like other controllable expenses, since *it costs the same to provide a dollar's worth of service whether or not the firm invoices and collects it*.

In fact, write-downs usually can be allocated directly to the responsible PIC. Accordingly, it is recommended that write-downs be viewed as a dollar cost and shown as a separate line item like any other cost, rather than as a percentage reduction of standard fees.

Once an engagement is complete, all costs to create that service are sunk costs—nonrecoverable. That means *every dollar the firm invoices is 100-percent profit*. In this respect, write-downs are the most controllable cost because the amount to invoice is discretionary with the PIC. Granted, there are marketing, competitive, and client relations aspects to consider. Nevertheless, write-downs are extremely controllable. Evidence of this is that different PICs in the same firm often have different realization on their respective **ledgers** even though they perform the same type of services for the same type of clients.

Exhibit 2-12, “Sample Profile Firm Economic Income Analysis,” shows how economic income relates to net income using traditional accounting for unincorporated businesses. It also serves as a double-check of your earlier calculations in Exhibit 2-10.

After completing this analysis, most accountants are surprised to discover their 30-percent to 50-percent profit margins quickly disappear.



THE KEY TO IMPROVING PROFITABILITY

The classical economist said, “Lower costs to increase profit.”

Many accountants who need more profitability look first at costs by asking, “How much are salaries, rent, training, telephone, publications, etc.?” Then, they ask, “What expenses can we cut so we make the right amount of money?” The reason is simple: At first blush, it appears that a cost reduction increases profits by the same amount. “A penny saved is a penny earned,” as Benjamin Franklin said.

Yet this maxim crumbles quickly upon close examination. Increasing profits solely by reducing costs is a tactic that runs out of steam. No matter how well the firm is managed, there is a certain irreducible limit that will eventually be reached. Expenses result from business activity—and these are almost an indicator of business health. Consider that it is possible to eliminate all expenses by closing the business!

KEY POINT: The question is not how to reduce expenses, but how to incur the *right* expenses to accomplish business goals in the most efficient manner.

Example: If Smith & Jones can use a refilled toner cartridge for a laser printer instead of a new cartridge, the savings comes straight down to increased profits *provided quality remains constant.*

Most people treat expenses as the most controllable item on the financial statements. Yet increasing profits by reducing costs can endanger the firm. Sometimes, cost savings may not translate into profits. Sometimes the reverse may be true.

If clients use the services of a firm, whether they come back depends primarily on how they feel about the experience. The more they feel rewarded by the interaction, the more likely they will continue to return. The same applies to prospects and referral sources who visit, telephone, and so forth.

Example: Consider the firm of Down & Out, whose profits are down one year on flat sales because they lost a major client. That loss offset the revenues from new clients.

To control costs, Down & Out trimmed personnel. They accompanied the employee freeze with sweeping cost reductions starting with reduced marketing. They deferred (again) updating their computers; they forbade lunches with referral sources and did not resurface their parking lot even though a hard winter caused some potholes.

These cost-control measures were meant to improve efficiency and reduce costs without adversely affecting service levels. Unfortunately, they achieved none of these goals.

Instead, Down & Out saved money on personnel by operating short staffed for three months. Client information took longer to process, and turnaround time increased. Then, the firm hired a newer low-wage clerk to do the filing and processing, but she had no office experience and input some data wrong. The result was that a management decision concerning internal efficiency hurt service quality as perceived by clients, giving the firm the equivalent of a *D* on its report card.

Other clients felt they were getting the same technical quality as before, but noticed that the firms' telephones weren't being answered as promptly; it now took seven or eight rings for clients to get through, instead of two or three. The firm's "bedside manner" deteriorated, and clients now gave the firm a *C*.

Ultimately, the firm finds, to its dismay, that *management decisions made solely with cost considerations in mind caused severe damage.* At the same time, the cost savings were only marginal, a phenomenon called the *cost-cutting trap.*

What happened? Down & Out instituted cost economies hoping to improve efficiency. But because *internal production processes are marketing resources as well,* the firm ended by reducing its ability to serve clients. Such decisions do not *always* lead to bad consequences; cost consciousness is important. Still, an amazingly high percentage of the time, mindless cost-cutting leads to trouble.

In the instance described above, the wrong strategy threw the firm into a downward spiral that weakened its competitiveness and aggravated the financial problems that prompted the bad decisions in the first place.

Once again, trying to increase profits by reducing costs can be dangerous.

KEY POINT: Some costs are *expenses* that do not directly produce revenue, but some costs are really *investments* that do produce revenue. The trick is to know which are which.

With great care, you can increase profits with cost control. Even so, to the extent you reduce costs, it is a one-time benefit. Once you increase your cost efficiency from, say, 80 percent to 99 percent, there is not much more you can do. Continued increases in profits after that point must come from somewhere else.

On the other hand, if you focus your efforts, imagination, and resources to increase productivity and generate additional value to clients—and thus additional revenue—there is no upper limit to what you can accomplish.

EXHIBIT 2-1: SAMPLE PROFILE FIRM INCOME STATEMENT

	PROFILE FIRM	YOUR FIRM
Revenue		
Standard Fees	\$1,952,300	
Write-Downs	70,000	
Net Sales	1,882,300	
Direct Expenses		
Salaries, Technical Staff	560,000	
Salaries, Support Personnel	87,500	
Total Salaries	647,500	
Consulting, Unallocated	12,000	
Data Processing, Unallocated	37,000	
Total Direct Expenses	696,500	
Indirect Expenses (Overhead)		
Employees	142,000	
Facilities	160,000	
Marketing	34,500	
Other Operating Expenses	100,500	
Nonoperating Expenses	35,000	
Total Indirect Expenses	472,000	
Net Income (Using Traditional Proprietorship-Partnership Accounting)	713,800	
Net Income Per Owner	\$ 237,933	
Profit Margin (Partnership GAAP)	37.92%	

EXHIBIT 2-2: SAMPLE PROFILE FIRM BALANCE SHEET

	PROFILE FIRM	YOUR FIRM
Assets		
Cash	\$7,500	
Receivables, Invoiced	170,000	
Work in Progress	145,000	
Allowance for Doubtful Accounts and Billing Adjustments	(10,000)	
Other Current Assets	5,000	
Total Current Assets	317,500	
Building and Leasehold	25,000	
Furniture and Equipment	125,000	
Accumulated Depreciation	(75,000)	
Others	5,000	
Total Assets	\$397,500	
Liabilities		
Notes and Loans Payable to Bank	\$25,000	
Payables and Accruals	15,000	
Total Current Liabilities	40,000	
Long-Term Debt	50,000	
Total Liabilities	90,000	
Capital Accounts	307,500	
Total Liabilities and Capital	\$397,500	

EXHIBIT 2-3: SAMPLE PROFILE FIRM ANALYSIS OF FEES

LEVEL OF PERSONNEL	NUMBER OF PERSONS	CHARGEABLE HOURS	EXTENDED	STANDARD CHARGEOUT RATE	STANDARD FEES
Owners					
Executive/MCS	1.0	1,100	1,100	\$150	\$165,000
Audit	1.0	1,400	1,400	100	140,000
Tax	1.0	1,400	1,400	125	175,000
Total Owners	3.0	1,300.00	3,900	\$123.08	480,000
Technical Staff					
Staff (1 year)	2.0	1,600	3,200	55	176,000
Staff (2 years)	3.0	1,650	4,950	57	282,150
In-Charge (2 years)	3.0	1,650	4,950	60	297,000
In-Charge (3 years)	2.0	1,650	3,300	65	214,500
In-Charge (3 years)	3.0	1,650	4,950	67	331,650
Manager (6 years)	1.0	1,600	1,600	90	144,000
Total Technical Staff	14.0	1,639.29	22,950	\$62.98	1,445,300
Total Owners and Technical Personnel	17.0	1,579.41	26,850		1,952,300
Support Personnel					
Administrative Assistant	1.0	300	300	40	12,000
Other	2.5	200	500	30	15,000
Total Support Personnel	3.5	228.57	800		27,000
Total Technical and Support Personnel	17.5	1357.14	23,750		1,472,300
Total All Personnel	20.5	1348.78	27,650		1,952,300
Write-Downs				3.6%	70,000
				Net sales	\$1,882,300

**EXHIBIT 2-4: SAMPLE PROFILE FIRM EMPLOYEE BILLING
MULTIPLES CALCULATIONS**

<i>Level of Personnel</i>	<i>Standard Charge-out Rate</i>	<i>Compensation</i>		<i>Billing Multiple</i>
		<i>Including Overtime</i>	<i>Base Pay</i>	
Technical Staff				
Staff (1 year)	\$ 55	\$ 32,500	\$ 28,705	0.001916
Staff (1 year)	55	32,500	28,705	0.001916
Staff (2 years)	57	37,500	33,121	0.001721
Staff (2 years)	57	37,500	33,121	0.001721
Staff (2 years)	57	37,500	33,121	0.001721
In-Charge (2 years)	60	38,000	33,563	0.001788
In-Charge (2 years)	60	38,000	33,563	0.001788
In-Charge (2 years)	60	38,000	33,563	0.001788
In-Charge (3 years)	65	41,500	36,654	0.001773
In-Charge (3 years)	65	41,500	36,654	0.001773
In-Charge (3 years)	67	43,500	38,420	0.001744
In-Charge (3 years)	67	43,500	38,420	0.001744
In-Charge (3 years)	67	43,500	38,420	0.001744
Manager (6 years)	90	55,000	48,577	0.001853
Total Technical Employees	\$882	\$560,000	\$494,607	0.001783
Support Personnel (no overtime)				
Administrative Assistant	\$ 40	\$ 30,000	\$ 30,000	0.001333
Other	30	23,000	23,000	0.001304
Other	30	23,000	23,000	0.001304
Other	30	23,000	23,000	0.001304
Other	30	23,000	23,000	0.001304
Total Support Personnel	\$160	\$122,000	\$122,000	0.001311

EXHIBIT 2-5: SAMPLE EMPLOYEE BILLING MULTIPLES FORM

<i>(1)</i> <i>Level of Personnel</i>	<i>(2)</i> <i>Chargeout Rate</i>	<i>(3)</i> <i>Base Annual Compensation</i>	<i>(4)</i> <i>Billing Multiple</i> <i>(Column 2</i> <i>Divided by</i> <i>Column 3)</i>
Technical Personnel			
Total technical personnel			

EXHIBIT 2-6: SAMPLE PROFILE FIRM FAIR-MARKET VALUE OF OWNERS' SALARIES CALCULATIONS

<i>Executive/MCS Owner</i>	<i>Profile Firm</i>
1. Executive/MCS owner chargeout rate	\$150.00
2. Divide by employee billing multiple	.001853
3. [Line 1 divided by Line 2] Average fair-market value salary of owner	\$80,950

<i>Tax Owner</i>	<i>Profile Firm</i>
1. Tax owner chargeout rate	\$125.00
2. Divide by employee billing multiple	.001853
3. [Line 1 divided by Line 2] Average fair-market value salary of owner	\$67,458

<i>Audit Owner</i>	<i>Profile Firm</i>
1. Audit owner chargeout rate	\$100.00
2. Divide by employee billing multiple	.001853
3. [Line 1 divided by Line 2] Average fair-market value salary of owner	\$53,967

<i>Average</i>	<i>Profile Firm</i>
1. Average owner chargeout rate	\$123.08
2. Divide by employee billing multiple	.001853
3. [Line 1 divided by Line 2] Average fair-market value salary of owners	\$66,422
4. Times number of owners	3
5. [Line 3 times Line 4] Total owners' salaries	\$199,266

<i>Sample Firm Market Salaries</i>	<i>Fair-Market Salary</i>
Audit owner	\$71,500
Tax owner	89,375
Executive/MCS owner	107,250
Total	\$268,125

EXHIBIT 2-7: SAMPLE FAIR-MARKET VALUE OF OWNERS' SALARIES FORM

	THE OWNER, PERSONALLY	YOUR FIRM
1. Average owner chargeout rate		
2. Divide by employee billing multiple		
3. [Line 1 divided by Line 2] Average fair-market value salary of owners		
4. Times number of owners	Not Applicable	
5. [Line 3 times Line 4] Total owners' salaries	Not Applicable	

EXHIBIT 2-8: SAMPLE PROFILE FIRM INTEREST ON CAPITAL CALCULATION

	PROFILE FIRM	YOUR FIRM
6. Average accrual-basis capital	\$307,500	
7. Times interest rate	10%	
8. [Line 6 times Line 7] Interest on capital	\$ 30,750	

EXHIBIT 2-9: SAMPLE PROFILE FIRM STANDARD FEES CALCULATION

	PROFILE FIRM	YOUR FIRM
9. Net sales	\$1,882,300	
10. Add write-downs (deduct write-ups)	70,000	
11. [Line 9 minus Line 10] Standard fees	\$1,952,300	

EXHIBIT 2-10: SAMPLE PROFILE FIRM ANALYSIS

	PROFILE FIRM	YOUR FIRM
11. Standard fees	\$1,952,300	
12. Economic expenses		
12a. Technical employees salaries	560,000	
12b. Add owners' salaries [Line 5 above]	268,125	
12c. Total technical salaries	\$ 828,125	
12d. Percent of standard fees	42.42%	
12e. Support personnel salaries	\$87,500	
12f. Other direct expenses	49,000	
12g. Indirect expenses	472,000	
13. Add interest on capital [Line 8 above]	30,750	
14. [Line 12a through Line 12g plus Line 13] Total economic costs and expenses	\$1,467,375	
15. [Line 14 divided by Line 11] Percent of standard fees	75.16%	
16. [Line 11 minus Line 14] Economic profit on standard fees	\$ 484,925	
17. [Line 16 divided by Line 11] Percent of standard fees	24.84%	
18. Write-downs [Line 10 above]	\$70,000	
19. [Line 18 divided by Line 16 times 100] Percent of economic profit	14.44%	
20. [Line 16 minus Line 18] Economic income (entrepreneurial results)	\$ 414,925	
21. [Line 20 divided by Line 11 times 100] Percent of standard fees	21.25%	

EXHIBIT 2-11: SAMPLE PROFILE FIRM OVERHEAD ANALYSIS

	PROFILE FIRM	YOUR FIRM
Total economic costs and expenses [Line 14 above]	\$1,467,325	
Less technical salaries [Line 12c above]	828,125	
Equals overhead cost	\$ 639,250	
Overhead costs as percent of salaries	77.19%	

EXHIBIT 2-12: SAMPLE PROFILE FIRM ECONOMIC INCOME ANALYSIS

	PROFILE FIRM	YOUR FIRM
Net income (traditional method)	\$713,800	
Less owners' salaries	268,125	
Less owners' interest	30,750	
Economic income (entrepreneurial results)\$	\$414,925	

CHAPTER 3

THE PRICING MYTHS

Unconsciously, most certified public accountants (CPAs) accept certain myths as if they were among the Ten Commandments. How many of the following myths do you accept without thinking?

- The only ethical way to price services is by the hour. That's fair to the clients and fair to the CPAs.
- CPAs should do the job first and worry about fees later.
- If CPAs raise their prices, they will lose many of their clients.
- CPAs should raise prices only if demand exceeds supply.
- If CPAs do good work, clients will appreciate the quality and will pay for it.
- CPAs are paid for the products and services they deliver.
- If CPAs do not charge clients for all the work they do, the clients will be more likely to pay their invoices.
- Last year's price is a good guide for this year's price.
- The amount recorded on the CPAs' time-keeping system indicates the maximum fair price for the engagement.
- Paying their invoices is as high a priority for clients as getting paid is for CPAs.
- If CPAs charge less than their colleagues, they will get more clients *and* the clients will pay their invoices.
- The client's gratitude for a good job done endures long after the job is finished.
- Asking clients to pay is unprofessional.
- If CPAs do ask clients to pay, the clients will take their business elsewhere.
- The client in the office now is the last client the CPA firm will ever get. Therefore, it is better to (1) not make the client angry by asking for a substantial advance payment; and (2) take whatever the client will pay because something is better than nothing.
- If CPAs give clients a discount, the clients will be so happy they will recommend the firm to friends or do other nice things for the CPAs.
- If a CPA or anyone else in the firm makes a mistake, the time involved should be written off.
- What CPAs do cannot be very valuable, because it is easy for them.

These myths costs thousands of CPAs millions of dollars every day. And they are shooting themselves in the foot.

These myths are not imposed by law or ethics, only by attitudes. (There's that word *attitude* again.) These myths subconsciously remain in the background of most accountants' thinking and the forefront of their habits. Thus, they remain in place until accountants consciously change them.

I do not know whether these myths were ever true, but they are not true today. How many of these do *you* unconsciously accept?

Let's look at these myths one more time, but this time I will examine the realities behind these myths.

Myth: *The only ethical way to price services is by the hour. That's fair to the clients and fair to the CPAs.*

Reality: The American Institute of Certified Public Accountants (AICPA) has no ethical restrictions that prevent a CPA from pricing services on a different basis.

Independence and objectivity are essentials in the practice of accounting. Certain pricing methods, such as commissions, contingent fees, success fees, and the like, are often acceptable if the client is aware of the pricing before you start the engagement, and the pricing agreement complies with the rules of conduct of the AICPA and your state board of accountancy.

Myth: *CPAs should do the job first and worry about fees later.*

Reality: There is always time to discuss prices.

You don't work in the emergency room of a television hospital where clients are frantically wheeled in the door on a gurney with blood spurting from severed arteries. "Quick, she needs a financial statement for a meeting with her banker on Monday!!!"

You must make a profit to stay in business. It is in the best interest of clients for you to be prosperous so you can remain in business to serve them. It is also in clients' interest for the profession as a whole to be profitable enough to continue to attract high-quality people to the profession to protect its future ability to serve the market.

KEY POINT: Most accountants don't understand that all they have to sell is time and information. Giving away either one reduces financial success and sends the wrong message to clients.

Myth: *If CPAs raise their prices, they will lose many of their clients.*

Reality: If CPAs raise prices, *some* clients might leave, but far fewer than anticipated.

I have coached hundreds of accountants through price increases ranging from 10 percent to 35 percent. Clients notice only when the increases approach 20 percent or more.

KEY POINT: Most clients give their CPA's invoice about as much attention as they give their electricity bill.

When I was a teenager, I was very concerned about what my peers thought of me. If you have teenagers, you may recognize this characteristic. I had to wear the right clothes and the right hairstyle. I had to listen to the right radio station and dance the right dances. My father used to bring me down to earth by saying, "Son, you wouldn't worry so much what other people thought about you if you knew how seldom they think about you."

By the same token, I say to accountants, "You wouldn't worry so much about what clients think about your prices if you knew how seldom they think about them."

After 12 years of practicing accounting followed by 23 years as a consultant to the profession, I have concluded that accountants are more price conscious than their clients! And the clients who are most price sensitive are frequently your least desirable clients—the ones a CPA would be better off without.

Myth: *CPAs should raise prices only if demand exceeds supply.*

Reality: If CPAs work smart, demand should *never* exceed supply.

No CPA should want to be booked every available hour because the result is the following:

- No time to plan and manage
- No opportunity to take advantage of marketing opportunities
- No opportunity to respond to client or firm emergencies
- No personal life

As your firm develops, you should make more and work less, because your skills and reputation make you more valuable to clients.

Practical Tips: Increase prices—that is, the amount charged for the value delivered—as that value increases.

Myth: *If CPAs do good work, clients will appreciate the quality and will pay for it.*

Reality: Technical quality is invisible to clients. They take it for granted.

Most clients assume, rightly or wrongly, that all accounting firms of a given size are comparable in technical proficiency. For the most part, they are right—thanks to good education and self-regulation by the profession.

Consequently, you cannot market your services by saying, "Use us! Our accounting principles are more generally accepted than those of our competitors!" (By the way, avoid the word *competitors*, especially when talking to clients, prospects, and referral sources. It is much better to call them *colleagues*.)

Myth: *CPAs are paid for the products and services they deliver.*

Reality: This concept of *deliverables* is important only to the extent that the tangible report is evidence to the client of the intangible service you perform.

By themselves, reports, tax returns, letters, and so forth, have very little value. But, by demonstrating, “We put the *care* in *ElderCare*” (or the equivalent marketing message for whatever service you are rendering), they can be very valuable indeed.

Myth: *If CPAs do not charge clients for all the work they do, the clients will be more likely to pay the invoice.*

Reality: Clients do not know how much work their CPAs do, nor how much the CPAs write off.

I have asked entire rooms full of accountants, “When you send a client an invoice, how often do they know whether you took a write-down or write-up?”

Over 80 percent of my audiences tell me that their clients almost never know whether the accountant takes a write-down because accountants do not show write-downs on the invoice or otherwise inform the client there was a write-down.

Since most of the work you do for smaller clients is done in your own offices, most of the work you do for clients is invisible. British consultant Mark Lloydbottom calls it the *iceberg of time* because most of your time is “below the waterline,” where clients cannot see it.

KEY POINT: If CPAs do not value their time or work, neither will their clients.

Myth: *Last year's price is a good guide for this year's price.*

Reality: Things are almost always different; the client just is not aware of the differences.

Why? That's easy—because you do not tell them.

In all the years I practiced accounting, I only did two engagements that were exactly the same—tax returns for identical twins whose only income came from a trust set up by their grandparents. Every other engagement I did for every client had at least some difference from year to year. Even if the client had the same deductions on the same schedules, the amounts had to be reviewed against tax law changes.

Since every year is different, it makes sense that the price will be different. You must explain in your invoice the factors that were different.

Myth: *The amount recorded on the CPAs' time-keeping system indicates the maximum fair price for the engagement.*

Reality: Any relationship between the amount of work-in-progress (WIP) and the true value of the job may be only coincidental.

The amount on your time-keeping system only indicates what you invested in an engagement at standard. It has little or nothing to do with the value of the work.

Myth: *Paying their invoices is as high a priority for clients as getting paid is for CPAs.*

Reality: Some clients don't pay simply because they have not been asked to.

And, since too many accountants do not charge interest on past due accounts, it costs clients nothing to delay. Set the right expectations with your clients from day one.

Myth: *If CPAs charge less than their colleagues, they will get more clients and the clients will pay their invoices.*

Reality: Clients do not know what their CPA's colleagues charge, nor do they care.

In fact, not only do your clients not know what your colleagues charge, most accountants *also* do not know what other CPAs charge.

Myth: *The client's gratitude for a good job done endures after the job is finished.*

Reality: Clients quickly forget what their CPA did for them.

That's why you should send your invoices as soon as possible after a service is complete.

Myth: *Asking clients to pay is unprofessional.*

Reality: Not asking clients to pay is unprofessional.

If you want clients to respect you as a trusted business adviser, then you should lead by example and run your own business in a businesslike manner. Invoicing promptly and holding clients accountable to your payment terms sends the right message about your firm as business advisers.

Would you use a family doctor who was obese, out of shape, or smoked?

Clients will respect you if you make them pay. They will not if you don't.

Myth: *If CPAs do ask clients to pay, the clients will take their business elsewhere.*

Reality: If clients do not pay, they are not clients.

Do you know what you call an activity that you work hard at but don't get paid for? A hobby.

It is not fair to your good clients to do work for people that don't pay while you make good clients wait.

Back when I was in practice, a client sent one of my partners the details of a proposed transaction and asked him to write a tax opinion letter before the parties could close. Several days later the client (who was a good client otherwise, but delinquent on his account) called my partner and asked why the opinion had not been sent. "I need that opinion letter to close on this deal."

My partner replied, "I've been too busy working for clients who pay me to work on your opinion letter."

The client sent a check for his invoice by messenger that afternoon.

It would have been far easier for my partner to avoid confronting the client and simply do the work and hope for the best. But he was right in thinking it would not have been fair to our many good-paying clients to let one procrastinator go to the head of the queue. My partner collected the invoice by being friendly but firm—and sent a powerful message to the client.

Myth: *The client in the office now is the last client the CPA firm will ever get. Therefore, it is better to (1) not make the client angry by asking for a substantial advance payment; and (2) take whatever the client will pay because something is better than nothing.*

Reality: The world is full of clients.

Clients come and clients go. There will always be another client. Ed Slott, a CPA in Rockville Centre, New York, told me the Rule of SW3.

KEY POINT: The Rule of SW3—"Some will. Some won't. So what?"

One of the reasons I was so financially successful as a practicing accountant was that I had what I call *walk-away power*. I had the emotional ability to simply walk away from any client—even my largest client—and never regret it. My attitude? "The world is full of clients; let the bad ones go someplace else."

Myth: *If CPAs give clients a discount, the clients will be so happy, they will recommend the firm to friends or do other nice things for the CPAs.*

Reality: Many accountants give new (and old) clients a discount even though the clients neither ask for it nor expect it.

Think about this: Starting a new client off at a substandard price teaches them to expect Cadillac service for the price of Chevrolet. This makes it hard to raise them to a fair price later because they have been spoiled. So, start them out right in the first place.

Myth: *If a CPA or anyone else in the firm makes a mistake, the time involved should be written off.*

Reality: Mistakes are part of life and part of business.

Your standard rates already allow for the fact that you make mistakes; likewise for your employees. Their salary and chargeout rates reflect their level of experience and performance. If you or your team never made mistakes, your chargeout rates would be much higher.

If someone makes a mistake, that does not make the time nonchargeable. They should note on the time sheet that a mistake was made, but charge the time anyway. Perhaps at another point on the engagement, they (or someone else) will be super-efficient and fin-

ish in less time than you thought. You may be able to invoice all your costs. If not, the write-down will reflect how well you managed your costs.

Myth: *What CPAs do cannot be very valuable, because it is easy for them.*

Reality: The things that come easy to CPAs are impossible for the clients.

It's amazing how few people know what they are good at. What comes easy one tends to disparage. If it comes easy, value it. One thinks that what comes hard is more valuable because you have to work at it.

Peter Drucker in Inc. Magazine, March 1998, p. 67.

A skilled surgeon once asked the following rhetorical question:

Do you know how long it takes a good surgeon to remove an appendix from first incision to closure? Seven minutes. If you gave me two hours with anyone smart enough to finish college in four years, I could teach him or her how to remove an appendix. It's really very simple.

But do you know how long it would take me to teach that same college graduate what to do if something went wrong while removing that appendix? Six years of medical training.

CHAPTER 4

HOW TO SET PRICES

To set the right prices, you have to know your cost to service each client and your cost to provide each type of service.¹ The key to this is to use your time-keeping system as a retail cost accounting system.

Your time-keeping system should provide:

- **Productivity** information by person, including chargeable hours, total hours, and comparison to target on a weekly or monthly basis
- Realization information by person, including the net effective chargeout rate attained after allocating write-downs to personnel who worked on the engagement, net revenue produced, and comparison to target monthly
- Proper allocation of time charges to clients
- Proper allocation of write-downs to clients
- Proper allocation of write-downs to the responsible person in charge (PIC)
- Daily time reporting and daily billing
- Automatic verification while inputting client numbers, work codes, and employee numbers
- Grouping related clients and treating them as one client for analysis purposes
- Printing a list of clients and related cost and revenue information sorted by fees (ascending or descending), realization (ascending and descending), and the absolute size of write-downs (ascending and descending)
- Exporting appropriate files to your spreadsheet program

Many of my clients look at the above criteria and think they will need to invest in new time-keeping software. Actually, your current time-keeping system may provide most of these features. It might provide all, but you need to study the operating manual. Most systems generate far more management reports than you need. If your current system does not provide this information, you should invest in a new system; the modest cost will be recovered quickly through more useful management reports. There are numerous software products available, which provide this information.

This chapter will discuss several pricing concepts (chargeable time versus billable time and factors that affect your prices), when to use value pricing, results pricing, and fixed pricing, how to package your services, and how to raise prices.

¹ All CPAs must comply with both the AICPA code and local state accountancy board regulations regarding fee arrangements. The AICPA rules may be found at <http://www.aicpa.org/about/code/ed302.htm> and <http://www.aicpa.org/about/code/ed503.htm>. Links for state jurisdictions may be found at <http://www.aicpa.org/states/info/index.htm>.



CHARGEABLE TIME OR BILLABLE TIME?

Chargeable time is time spent that is identifiable with serving a particular client, regardless of whether or not the client is ultimately invoiced for the time charges. Chargeable time measures the cost of serving the client. Since accounting firms record their time at standard chargeout rates, which include a standard profit, some CPAs, and especially less-experienced staff, are confused about the distinction between *chargeable* time and *billable* time based on whether they intend to send an invoice for the service. This confusion causes some professionals to think that, if they are not going to invoice the client for the charges, they should not record the time.

This is a major cause of lack of profitability, because failing to record all chargeable time distorts the cost records for that client. The next time you have to set a price or make a budget, you don't know how much it cost to do the job last year, and your pricing decisions are less accurate.

Charging time to a client is not the same as *invoicing* a client. These are two different management decisions:

- First, what does it cost to perform this service for the client?
- Next, how should I price this service?

At times you may perform a service and choose not to invoice the client for whatever reason. Nevertheless, the time spent performing that service is a *cost of serving that client* which you should know in order to make better decisions.

KEY POINT: Your time-keeping system has *two* functions. First, the system records the cost of serving each client (the *time-keeping* part of the system). Second, it keeps track of your accounts receivable from the client; this is the *invoicing and accounts receivable* part of the system. Don't confuse them.

Also, some CPAs routinely reduce or increase their standard charges before invoicing. These accountants often decide as they record their time how much they will invoice for the work.

If they don't intend to invoice the client for the work, they will not charge the time to work in progress (WIP). For example, if they intend not to invoice the client for looking up an item in the file, copying it, and sending the client the copy, they record the time in a non-chargeable category (or do not record it at all). On another project, they might work ten hours at \$250 per hour but intend to give the client a discount. So, they only record eight hours. Again, *this is a major cause of lack of profitability* because these accountants lose track of the true cost of serving such clients.

On the other hand, if they spend 15 minutes looking up some research they had previously done in three hours for another client, they may record three "billable" hours for 15 minutes' work, thus using the time-keeping system to record the price that they intend to invoice. But this distorts the cost of serving that client.

Nonchargeable time is time worked that is not chargeable to a client. This includes training, recruiting, professional meetings, practice development, administration, and firm meetings, no matter whether the time is spent during regular business hours or not. It also includes civic activities, vacations, holidays, and authorized leaves of absence during business hours.

KEY POINT: The criterion for whether time is chargeable is: If I did not have this client, would I have spent this time doing something else? If the answer is yes, the time is chargeable.

There is another danger in making pricing decisions at the time you record your time: Your employees will follow your example. They will usurp *your* pricing decisions by deciding whether or not to record time spent serving clients. If you don't know the time was spent, you never get the chance to make the pricing decision. Again, *this is a major cause of lack of profitability!*

KEY POINT: The single most important type of information you, as a manager, need is, "*How much does it cost me to serve each and every client?*"



FIVE FACTORS THAT AFFECT YOUR PRICES²

Five factors affect the amount you can charge for your services:

1. *Demand for your services.* Obviously, there is more demand for automobile mechanics than buggy-whip makers. Market changes and technological advances can affect demand. Nevertheless, for accountants, demand depends on your marketing success (for new business) and your success at managing clients (for the retention of current clients and the development of more business from them).
2. *How easily you can be replaced.* Most people would agree that garbage collectors are more necessary than doctors to the functioning of modern society. Yet, we pay doctors more because they are harder to train and harder to replace. For accountants, replaceability depends on market position (for getting new clients) and client management skill (for relationships with current clients).
3. *Ability.* This is synonymous with efficiency, meaning, "doing things right." For accountants, personal expertise, time management skill, and employee training affect efficiency.

² Adapted with permission of Aspen Publishers, 2000, David W. Cottle, *Professional's Guide to Target Marketing: How to Gain Profitable New Business*, "How to Discuss Prices," pages 229–230, www.aspen-publishers.com.

4. *Return on investment of resources.* This is effectiveness, meaning, “doing the *right* things right.” An individual’s resource is his or her time. A firm’s resource is employee and owner time. Owners improve their return on investment (ROI) with better time management, delegation, and supervision of employees.
5. *Courage to demand what you are worth.* You could have all four of the preceding factors under control and still not earn what you are worth. You could be in such demand that you have clients lined up waiting for you to get to them. You could be so close to your clients that they will not make a major move without consulting you. You could have the most efficient practice in the entire country. You could spend your time working at the top of your professional capabilities.

You still won’t be paid what you are worth unless you are willing to demand a fair price for your services. And you must have the *walk-away power* to not work for anyone who is not willing to pay a fair price.

Remember that you can do it, and that the vast majority of your clients will accept price increases.



WHEN TO USE VALUE PRICING

Value pricing means pricing your services based on their value to your client, rather than on your cost to provide them.

You can and should price many engagements based on value to the client rather than time spent.

The Value Gap

A partner in a very successful Canadian accounting firm told me this story:

I attended a management conference at which the speaker said, “If none of your clients ever complain about your fees, you’re not charging enough! In fact, if you don’t lose at least one client a year over fees, you’re not charging enough.”

I thought about it and realized that in 25 years as an accountant, I had *never* had a fee complaint.

I had just completed drafting invoices for a bunch of individual tax returns which totaled \$90,000. I looked at each draft again and asked myself how much each tax return was actually worth to the client, and—disregarding the time charges—I wrote most of them up based on value instead of standard fees.

Under the old system, I would have invoiced \$90,000. Instead, I added them up, and the new total was \$117,000, a 30-percent increase. I gulped, but each invoice was fair. I mailed them out and sat at my desk with my hand on the telephone waiting for (I thought) the inevitable complaints.

I didn’t get a single call! So the next year I raised my fees again!”

Another CPA from Dallas told me the following story:

I had a client with a closely held corporation that had a net operating loss. I prepared an application for quick carryback to get her a \$14,000 refund.

I had just attended a seminar on value pricing and decided to charge her \$750, three times my usual rate. I sent the refund form and my invoice in the same envelope.

She telephoned me in a couple of days. “I just got the tax form. Does this mean that I’m going to get back \$14,000?”

“Yes,” I told her, “In about six weeks.”

“Oh, goody!” she said, and she mailed me a check to pay my invoice.

Why was this woman so happy to pay \$750 when the CPA was uncertain whether to charge more than his \$250 standard fee? Referring to the investment versus value comparison in Chapter 1, “Pricing Methods in the CPA Profession,” the client focused on the “benefit, results, output, return on investment”—the *value* side—the \$14,000 refund. The CPA focused mostly on his “effort, input, investment, time”—the *cost*.

The rest of the story (in the CPA’s words):

Six weeks later the lady called me. “Jack, I just received my \$14,000! How much of that do I owe you?”

For any professional relationship to continue, the client must believe that he or she receives more benefit from the services than they cost. The client must perceive more output than input, more ROI than the amount of the investment.

KEY POINT: The simple truth is that most clients usually value your services higher than you do.

I’ll repeat here something I said much earlier in the book.

KEY POINT: CPAs are more price conscious than their clients.

One of my clients tells this story:

Over 20 years ago, when I was a new practitioner, I prepared a lady’s tax return. I carefully considered the amount of time I had spent and appropriate computer charges. I decided that \$400 was a fair fee and sent her an invoice for that amount.

She sent me a check for \$600 by return mail.

I was intrigued by the fact that she had seen more value in my service than I had. I investigated and discovered that — although I had drafted an invoice for \$400—my secretary had actually invoiced \$600. Whether my secretary could not read my handwriting or just hit the wrong key, I don’t know.

But the fact remained: The client saw at least 50 percent more value than I did.

If the speed of payment is any indicator of satisfaction (and it is), the client must have been quite happy with the service and presumably would have been willing to pay even more—possibly even \$900. We also can assume that the CPA would have invoiced less if this were a whiny client who complained a lot—perhaps as little as \$300.

These stories, and many others I could tell, illustrate two fundamental facts:

KEY POINT: Often, clients *do not know* what your services are worth.

KEY POINT: Often, accountants also do not know what their services are worth.

The stories above also illustrate what I call the *Value Gap*.

KEY POINT: *The Value Gap* is the amount which clients are willing to pay in excess of the amount which the accountant has the courage to charge.

Factors Affecting Value

Besides objective elements, such as time at standard rates and other direct chargeable expenses, you should consider subjective factors that warrant a price either higher or lower than standard.

For routine work, you can start with time charges at standard to determine the amount to invoice. After all, standard time charges reflect your costs in the engagement (plus a normal profit), and you have to recover your costs. Yet, the real criterion is the value to clients. Too often, accountants recognize this value only negatively by invoicing at less than standard rates. In other words, they will take write-downs but not write-ups.

Subjective factors³ which affect pricing include:

- *Special capabilities, skill, and professional expertise of the persons doing the work.* A person's standard chargeout rate for a service may not reflect their special expertise in a specific industry. Even though a manager's regular rate for consulting is, say \$150, if he or she has special experience in the client's industry, that would make him or her more valuable or efficient, you can justify a higher rate than standard.
- *Degree of risk and responsibility assumed.* Special services, such as the sale of a business and certain types of tax, management consulting, and specialist services, merit higher prices. Likewise, if you face special risks (such as the possibility of not getting paid if a startup company fails), you can charge a risk premium. If you supervise a multidisciplinary team, or otherwise carry greater than normal responsibility, you should charge more. The intended use of the accountant's report, and the possibility of liability also may indicate the risk and responsibility of the services rendered.

³ *Ibid.*, pages 232–236.

- *Seasonal factors.* Using dual chargeout rates has some of the effect of seasonal pricing, since a great deal of your tax work will fall in the busy season. Some firms go beyond that and assign a busy season premium of about 30 percent to all work done between January 1 and April 15. They often call it an “off-season discount” by raising all rates 30 percent and then allowing a 25-percent discount for work from April 16 to December 31.
- *Value of services to the client.* Logically, prices should directly relate to the value of the service performed for the client. And that value should also reflect the degree of risk involved, and the nature of the services. Often, standard time charges for a service do not correspond to the value of the service to the client. The most obvious situations include negotiating a higher sales price or a lower purchase price for a client, savings in taxes, increases in revenues, strategic planning, obtaining financing, as well as occasions when you help a client increase their profits. A complicated tax settlement may depend on the accountant’s thorough knowledge and judicious reasoning to gain a substantial savings for the client. Remember that it is knowledge that creates the “value” in the value of the services, not time.
- *The amounts involved.* The size of the transaction also indicates the value.
- *The results obtained.* Results are important in contingent prices or results pricing. Contingent prices are not allowed in all engagements nor in all jurisdictions. Check your local laws. But even in regular engagements, you may subjectively consider the results you obtained for the client.
- *Priority and importance of the work to the client.* If the client asks to “jump the queue” and have you reschedule appointments or delay work for other clients to make room for his or her project, the price should reflect these special arrangements.
- *Loss of access to other markets.* If you have a client who doesn’t want you working with their competitor, or if you enter into a contingent price with a client that depends on increases in the client’s profits (as many of my consulting contracts do), you might be precluded from working with that client’s competitors or from performing attest services. If so, you should charge a premium price because you are forgoing other opportunities.
- *Working conditions.* If the client’s location makes your employees feel uncomfortable, and they don’t want to work late because of fears for their personal safety, the client should be required to pay more.
- *Special efforts required.* If you worked all weekend on an otherwise routine engagement because the client had an emergency, you should charge extra. Such extra charges are normal in business. Customers pay a premium for convenience and overtime for faster service.

- *Difficulty of the engagement.* If you have to move heaven and earth to accomplish the engagement, you deserve a bonus. Also, consider the time limits imposed by the client or the circumstances.
- *Length of time you have been involved with the client.* A client whom you have served for many years would deserve more consideration than a one-shot client who came to you for one high-value consulting service but who remained the regular client of another firm. On the other hand, working for a client with whom you have “earned your spurs” means you are much more effective because of your long familiarity with the client’s affairs, and you can create more value more easily than with a newer client. That is why long-standing clients will accept a higher price than new ones because the old clients know you will do a super job.
- *Acceptability of the price (both to you and to the client).* It makes no economic sense for you to charge a client \$10,000 for an engagement that made him or her only \$6,000; it likewise makes little sense for you to charge a client \$10,000 for an engagement that made him or her \$1 million. For example, one of my clients helped a group of doctors increase the sale price of their practice from \$6 million to \$13 million...and charged only \$100,000 for the service—clearly, too little based on the value the firm created for the doctors.

Certain types of engagements usually deserve pricing above standard, namely, tax controversies, financial planning, investment advice, tax planning strategies, property tax protests, engagements that increase the client’s profits, and negotiating the purchase or sale of a business.

These engagements may have characteristics such as the following:

- Often, the client can measure the benefit. Examples are the reduction in a proposed tax assessment; the change in the purchase or sale price for a business; revenue increase.
- The engagement involves a future orientation that will affect the client’s future welfare, such as helping set up a trust that will care for a disabled dependent after the client’s death.
- There is a multiplier effect, whereby the client can profit repeatedly into the future such as negotiating a franchise or royalty agreement for a client.
- There is upside potential for client. If the results of the engagement work well, they may get even better in the future.
- Usually, the client does not have the necessary skill to do the work himself or herself.
- The client may have the skill but not the time. They may have no one else in the company to fill in. If you represent a \$500,000-a-year executive and free up his or her time to pursue other pressing interests, that certainly deserves more than \$300 an hour!

- The engagement is nonroutine and requires high-level technical skill, business acumen, or mature judgment.
- No one else can do the job as well. If “no one else has it,” you can charge more.
- Special resources or contacts you may have or competency you possess. If you can solve an important problem with a telephone call to the right person, that creates incalculable value.
- Requires cooperation with others? If you have to quarterback a team, that commands more value.
- The application of *knowledge, skill, or experience* is the driving force which creates value, not the expenditure of time.
- The client is sensitive about the project, such as:
 - The client’s financial well-being or business is threatened.
 - There is an opportunity for the client to earn a windfall profit if the outcome is successful.
 - The client wants comfort. The client simply wants you to be involved even though someone else, either in the client’s organization or outside it, could do it just as well.
 - The client’s ego is involved. Some people will pay lots of money because they think the more they pay, the more a thing is worth.
- Other professions charge for value when doing this. How would a lawyer charge for this? A real estate broker? A financial adviser?
- The amount of money involved is relatively large. The client may have substantial amounts of money at risk and depend on your skill to effect a favorable outcome.

Value pricing is particularly appropriate on value-added services or any other time when the monetary savings or extra revenue you produce for the client is visible to the client and measurable. If the value of your services is more than standard, you should charge above standard.

KEY POINT: Clients accept value pricing better than most accountants do, *if—* and *only if—* you discuss the price with them *before* you perform the service.

That’s the key. If you have a long history with a client of charging based on time, it’s not fair to surprise them with a value-priced engagement unless you discuss it in advance.

Arranging Payment With the Client

All clients are willing to pay a fair price. Of course, if you come across one that won’t pay a fair price, he or she becomes a *former* client. Accountants often lose sight of the fact that clients do not want to cheat you any more than you want to cheat them. *Clients want you to earn a fair fee.* Many accountants report that, on occasion, they have submitted an

invoice to a client and the client told them to charge more. Most clients are quite willing to pay a fair price because they know you must earn a living just like they do. Their chief concern is that other clients pay comparable prices.

Example: After their managing partner attended one of my seminars, one firm raised standard chargeout rates across the board by 20 percent.

They lost less than 2 percent of their clients.

The managing partner reported this typical incident:

I raised one client's fee from £1,500 to £2,500. He called to question the fee. When I explained that we had determined that our rates had been too low and had raised all rates 30 percent, he said, "What I want to know is: Are you ripping me off?" When I told him the price was fair and that he had been undercharged in the past, he was satisfied and remained a happy client.

This client, like most, simply needed reassurance that the firm's prices, while not cheap, were fair.

What sort of financial arrangements, if any, must you make with the client before value pricing? Even in routine engagements, allow for value pricing in the **engagement letter** terms. This is covered in Chapter 10, "Get It In Writing."

If value pricing opportunities arise, it's best to discuss the price with the client *before* you begin work. Then you can obtain his or her agreement about how you will price the engagement.



WHEN TO USE RESULTS PRICING

Other professions such as securities brokerage, investment management, and real estate brokerage base prices on results, often defined as a percentage of the amounts involved. You can do the same.

Results pricing is the practice of agreeing with the client in advance to charge based on the results you obtain, regardless of the amount of time involved. Commissions and contingent fees are examples of results pricing.

Results pricing is not a gratuity you add on for extra special service. That is value pricing. It is not invoicing an engagement with \$1,657 in WIP for \$1,750. That is normal invoicing practice.

Results pricing is not "getting lucky" by being able to invoice extra after an engagement is completed. You thought the research would take \$1,500 of time and you found the answer in one hour. That is value pricing.

It *may be* "standard fees plus a bonus" if the bonus is based on results.

Example: You can price business management/invoice paying services based on the number of transactions, i.e., checks you prepare. Or you could price this service on the amount of money involved, i.e., dollar volume of deposits made or checks prepared. Or both. Both bases reflect the value involved, yet neither necessarily reflects the time required.

You must position yourself for a results-based invoice by discussing the situation with the client *in advance*. Explain why it is worth what it is worth. Explain how you will contribute value to the client. And discuss the basis for your price. Explain that you bring unique skills that the client may not be able to get any other way.

KEY POINT: You cannot control the client's perception of your value *retroactively*. You must do it up front.

Use results pricing when the results are objectively measurable and the value to the client has little or nothing to do with the amount of time you require to do the job.



WHEN TO USE FIXED-PRICE AGREEMENTS

Fixed-price agreements transfer risk from the client to the CPA. In return for assuming the risk, you can charge a risk premium to the client by pricing at more than your standard rates. Many clients, given a choice, prefer to pay a little more in return for having a ceiling on their price.

Start with your estimated time at standard chargeout rates. Then add at least a 20-percent contingency because we all are too optimistic when we budget. Next, add the risk premium you earn by taking the risk off the client's shoulders. Finally, add any premium you want from bundling your services into packages.

Fixed-price agreements communicate confidence. An upfront quote projects confidence, experience, and competence on your part.

It also contains the seeds of disaster, if you are not careful.

How long could a restaurateur remain in business if he or she said, "I will feed you for \$250 a month?" How long would it take before the customers began to come in every day, and then every meal? Soon they would begin to order Lobster Newburg and an expensive wine. And if the restaurateur put up with that, then the customers could start to invite their friends to join them. And all for the same \$250!

Yet accountants often do the same thing. They quote a client a monthly retainer or a fixed price for an engagement and do not specify clearly what the engagement includes and—more importantly—does *not* include. Then they get gradually sucked in to doing more and more work each month.

DEFINITION: *Scope creep* is a phenomenon in which a project creeps beyond its original scope because the client keeps asking for additional services and the accountant provides them because there are no clear boundaries.

To avoid this disaster, the fixed-price agreement must specifically cover what you will do and then state that any additional work will be the subject of another agreement or a *change order*.

Example: My wife and I built a house in 1998. The original contract was for about \$320,000. It was a fixed-price agreement, but we wound up paying far more than that. Why? We added extras such as a larger bathtub, a swimming pool

enclosure, crown molding, extra cabinets, and so forth. The original contract was accompanied by a set of plans and specifications. Anything extra was extra. And for each of these extras, the contractor had us sign a change order.

We should learn from the example of my contractor. Accountants should also include “specifications and plans” in their agreements. I once had a client whose audit grew over the years to over 1,000 hours. I never missed budget by more than 2 percent, because I attached an exhibit to the engagement letter specifying all the work their personnel would do and its due dates. And each week I met with the client to review progress and make adjustments to both the budget and the price as the work progressed.

When I discuss reducing write-downs in a later chapter, I will cover the subject of planning conferences with both the client and your engagement team.

Irwin Steinberg, a former partner with the old Chicago firm of Friedman, Eisenstein, Raemer & Schwartz, put it best when he said, “Play the offense, not the defense.” That’s good advice in lots of areas.

If the contractor’s customer wants an extra, the contractor has leverage because they have already started the job and are familiar with it. The cost for the customer to switch contractors would be prohibitive at this stage. If you have real estate clients, you probably know that some contractors even lowball a bid and count on the change orders to provide all the profit in their job.



PACKAGING YOUR SERVICES

Have you ever noticed that some of the most valuable services accountants provide clients—suggestions for improving their businesses, suggestions that develop in the course of other engagements—are given for free? And have you also noticed that these valuable suggestions are usually ignored?

Accountants usually discuss business improvement ideas informally when they deliver tax returns or financial statements. They do not structure the advice as a separate service. They simply donate these valuable ideas to clients because they were developed incidentally to other engagements, usually for mandatory services. Because accountants are paid for the originally agreed-upon engagements, it doesn’t seem fair to charge clients for this additional advice. And besides, the clients didn’t ask for the advice, it was simply offered, which accountants consider part of “going the extra mile for clients.”

Sound familiar?

The irony is that by donating these valuable ideas to clients, accountants virtually guarantee that the client will ignore the advice. Why?

KEY POINT: People do not value that which they get for free.

You can include business advice as part of your service, include a fair price for it in the package, and clients are more likely to take your advice. They are also more likely to engage you for the separate service of implementing some of your ideas.

Exhibit 4-1, “Sample Firm Brochure Language for Packaged Services,” gives an example of how to turn your service into a product and quote a fixed price for it. This example takes the form of a firm brochure describing an accounting firm’s packaged services.

Packaging your services like this creates far more value than the standard chargeout rates of the time involved. Many accountants report that some of the clients they had thought were most price sensitive have actually chosen gold or platinum level service *when given the opportunity*.

Here’s how you can apply the packaging concept to individual clients. Exhibit 4-2, “Sample Letter for Promoting Packaged Services to Individual Clients,” is a letter sent out in November or December.



HOW TO RAISE PRICES

Suppose, after performing the analyses in Chapter 2, “How Much Do You Really Earn?” you decide your prices are too low. (Note that although this book uses the term *raise price*, when you discuss prices with clients, you never *raise prices*, you always *adjust prices*.) So, how do you raise them? You raise prices by raising prices.

Example: You charged Tina Taxpayer \$565 last year, and you think she should pay \$700 this year. Just do the work, and invoice her \$700. That’s only about a 24-percent increase. Most people have no problem with increases of less than 25 to 30 percent.

Example: You charged Clark Client \$465 last year, but, after reading this book and looking back at the value of what you did, you think you should have charged \$750. If Clark’s past record holds, this year will be even more complicated, perhaps to a fair price of \$800 or more.

After Clark brings in his information this year—but before you start work on it—you say, “Clark, I went back and looked at what we charged you last year and I realize that we should have charged you \$750 for the work we did. Also, we have made some adjustments to our prices since last year. This year, it looks like the price for your return will be about \$800, assuming it is no more complicated than last year. If it is more complicated, the price may be higher. Because this is significantly higher than we have charged you in the past, I wanted you to know about this price adjustment.”

If Clark has a problem with a \$750 or \$800 price, it is better for you to find out before doing the work. This gives him the opportunity to take his business elsewhere, and gives you the opportunity to stop working for less than you are worth.

It’s as simple as that.

Do you have to ask permission from most of your clients? No.

Do you have to notify your clients? No.

Just do it. Just go into your time-keeping system and raise your chargeout rates to whatever you feel is fair—even if you don't discuss the concepts in this book with your billers.

How to Make “Balanced” Changes

I have heard accountants say, “I can't increase my rates because I only get 95 percent of standard now.” Few accountants get 100 of standard consistently. Instead, I would advise that accountant, “Pat yourself on the back for that 95-percent realization, and raise your rates 15 percent.”

You can increase *effective* chargeout rates if you maintain the same realization and increase your average standard chargeout rate or maintain the same standard chargeout rates and increase realization. But if realization is over 90 percent, you will get only modest revenue gains with realization increases. Often, the best way to produce a desired increase in effective chargeout rates with the least change in operations is to make balanced changes in *each* of the following two factors:

1. *Current Realization Less Than 80 Percent.* If your current realization is less than 80 percent, I agree that an increase in chargeout rates may not be necessary, *provided you target an immediate increase in realization of at least 10 percent* each six months until you reach 80 percent.
2. *Current Realization Above 80 Percent.* If your current realization is at or above 80 percent, your entire increase in effective chargeout rates should be from higher chargeout rates. Let your realization remain where it is or even drift down a little as long as it remains above 80 percent.

My empirical observation is that the highest effective chargeout rates seem to be achieved with higher standard rates and realization rates somewhat above 80 percent.

If you do it the right way, you can normally increase rates 10 to 15 percent for employees and 10 to 30 percent for some owners, and clients will not even notice the change.

“But My Fellow Owners Will Never Go Along With That Large a Rate Increase”

Another way to increase prices is increase your employees' rates by \$2 each month and your owners' rates by \$5 each month until you get them as high as you want.

One client couldn't bear to raise rates all at once. So the firm raised partner rates 20 percent, employee rates 10 percent on October 1, and then raised all rates a further 10 percent January 1. Their realization remained about 99 percent.

Remember, most people equate high prices with high quality, especially if they have little else by which to judge value. Generally, the more people pay for something, the more valu-

able it is to them. Since professional services are an intangible that most clients cannot evaluate, they often evaluate them based on what they pay. It sounds contradictory, but you can actually increase your value to clients by simply raising your prices.



UNLEASH THE POWER OF UNCONDITIONAL SERVICE GUARANTEES⁴

You may have noticed the 100-percent satisfaction guarantee in Exhibits 4-1 and 4-2. If you take the risk, clients will pay you more. In fact, you guarantee satisfaction anyway, don't you? Why not turn it into a marketing advantage.

Here's the guarantee I put at the bottom of all my invoices:

Dear Client:

Our goal is 100-percent client satisfaction. This invoice is for the amount we discussed. If, for any reason, you feel this amount is inappropriate, please feel free to call me to discuss a more appropriate fee, or, you may simply send us a check for whatever you feel the service was worth.

If you wish to pay more than this invoice, please consider your best estimate of the value we have brought to you [*or your firm*] through this assignment and any additional value on the same subject you feel our engagement may have in the future.

You'll notice I give the client the option to pay more than the invoice. Why not? If I give them the right to pay less, it's only fair to remind them they can pay more, too. And some do.

⁴ *Ibid*, page 246.

EXHIBIT 4-1: SAMPLE FIRM BROCHURE LANGUAGE FOR PACKAGED SERVICES⁵



GROWING YOUR BUSINESS

Most people aim at nothing and hit it with surprising accuracy.

At Dewey, Servem & Howe, we believe that successful, sustainable growth results from careful planning, review, and implementation.

Real growth is a process, not an event—the gradual accumulation of many successfully implemented initiatives, both large and small. We completely customize our consulting approach to each client's needs. We believe that if we give you the individual attention you deserve, we can help you reach your destination so you don't wind up "hitting nothing."



FOUR LEVELS OF BUSINESS SERVICE

If you qualify as one of our *preferred clients*, we 100-percent guarantee that you will be delighted with our service. Further, you will take comfort from knowing that we are helping you take care of your business. You are the sole judge of our service. If you are not delighted, we will refund your payment. We ask only that you be honest with us and tell us how we have fallen short in your eyes, so we can learn and improve from the experience.



BRONZE SERVICE: MANDATORY REPORTS

Bronze service is what every business owner requires. It includes your choice of such matters as:

- Income tax preparation—federal, state, and city
- Sales tax preparation
- Payroll tax preparation
- Monthly or quarterly financial statements

In addition, you may want us to help you with other matters (such as license renewals, business surveys, employee information, etc.) that are required by government agencies, banks, and other regulators. You can pick and choose what you want included in your regular service.

Accurate financial statements show where you have been, where you are, and how you got from there to here. We believe that timely financial statements help every business. If you know how you got where you are now, it is easier to plan improvements to get where you want to go.

We recommend monthly financial statements, but even quarterly statements will identify some trends, and an annual statement will at least show the increase or decrease in your business from one year to the next. The decision as to how frequently to prepare financial statements is yours alone.

Typical prices for bronze level services range from \$400 to \$900 per month with the price depending on the amount of work you require.

We can also prepare your periodic payroll checks, payroll tax deposits, and W-2 forms, with prices determined by the number of transactions.

⁵ *Ibid*, pages 240-243.

**SILVER SERVICE: MANAGEMENT ACCOUNTING**

For *silver service*, we include all the bronze level services, meaning that we do more than meet government requirements and record historical information. We give you basic management tools.

We help you develop, monitor, and control your management report cards (MRCs) that apply to the critical areas of your business. “What you can measure, you can manage.” We help you find out what to measure—your MRCs—and how to use them to get better control over your business. We will work with you monthly to analyze your MRCs and discuss how they affect your business.

Typical prices for this service range from \$600 to \$1,500 per month.

**GOLD MEDAL SERVICE: MANAGEMENT ADVICE**

For *gold medal* clients, we go beyond the silver level MRC process to help you prepare monthly cash-flow forecasts and profit plans.

We show you how to use these valuable management tools to get better control of your business. We proactively help you interpret your periodic reports. We work with you on these monthly and, if needed, update your operating plan every three months.

Clients often hesitate to telephone their accountants to discuss an idea or concern because “the meter is running.” We believe that *not* making that call could cost you more than making it. We provide you with reasonable telephone access to our team for operational issues relating to properly recording, classifying, or handling your business transactions. We want you to call us. It is a good investment of your time and ours.

Typically, the price for gold medal service ranges from \$1,600 to \$2,500 per month.

**PLATINUM PERFORMANCE: CHIEF FINANCIAL OFFICER SERVICE**

At the *platinum level*, our team performs much like the chief financial officer (CFO) of a large company—the type of high-level professional capability that small and medium-sized businesses could not otherwise afford.

We help you develop your strategic plan, monitor it every three months, and update it annually. We focus on helping you discover the unexploited potential lying within your business. We focus on 12 or more specific financial and operating ratios that monitor your business success. [*Author’s note: You will come up with several dozen of these.*]

We aim to help you make your business even more profitable and therefore more valuable. This involves us in many nonaccounting areas of your business including financial planning, succession planning, market analysis, and helping you develop other business strategies.

Growing your business takes a great deal of time and effort. So, during this time, you will have unlimited telephone consulting privileges to discuss any issue related to developing your business.

The typical price for platinum service ranges from \$2,100 to \$3,500 per month.

EXHIBIT 4-2: SAMPLE LETTER FOR PROMOTING PACKAGED SERVICES TO INDIVIDUAL CLIENTS⁶

Three levels of individual services

Good morning [*Client*]

Fall is here.

And, 200X is just around the corner.

As the year comes to a close, we are planning ways to better serve and delight you during the upcoming tax season.

In fact, we are offering a select group of clients an opportunity to fit the services we provide to their financial goals. Why? Because we want the preparation of your income tax returns to be a pleasurable experience for you.

We are now offering you three tax packages so that you can choose the level of service you need. Each package includes the following basic services:

- Preparation of your federal and state income tax returns
- Two 10-minute telephone consultations
- Update of major tax law changes
- Estimated tax voucher reminder
- Year-end tax organizer
- Retention and storage of five prior years' tax returns
- Retention of passive loss records, historical costs, and depreciation of business property

NOW, YOU TELL US HOW TO BEST FIT YOUR FINANCIAL AND SERVICE GOALS...

The one surprise we don't want you to have is the price. Clients have told us they want to know their investment up front. Your financial situation may change, making your return more or less complex than in the past. We can adjust the level of service and investment to match your needs. Just tell us which of the following works best for you:

- *Mail Service.* No interview is needed and we answer any questions about your returns by phone, mail, fax, or e-mail throughout the year. Please let us know if your questions can be addressed after April 15, so that we can serve you best. Your investment for the Mail Service is \$_____. [*Author's note: This would normally be your minimum or the amount the client paid last year for the interview service, whichever is more.*]
- *Team Service.* One of our highly qualified team members will conduct your in-person interview and take responsibility for your returns to provide you with the service level you desire. Your investment in the Team Service is \$_____. [*Author's note: This would normally be about \$100 to \$150 more than Mail-in Service, depending on your personnel situation and how badly you want to free up owner time.*]
- *Partner Service.* The partner of your choice will conduct your in-person interview and oversee your returns from start to finish. Your investment in the Partner Service is \$_____. [*Author's note: This would normally be about \$100 to \$200 more than Team Service, again depending on your personnel situation.*]

For each level of service above, a partner or manager will thoroughly review all returns. Also, we have based your investment upon the assumption that no significant changes in your tax situation occurred during the last year. Any changes may require adjustments.

WE AGREE, NO ONE LIKES TO PAY TAXES.

⁶ *Ibid.*, pages 243-246.

Because of this, [*Firm name*] is dedicated to ensuring that your “fair share” is the lowest possible within the guidelines of the law. With that in mind, the team at [*Firm name*] offers the following commitments to you:

- We will act with integrity, honesty and openness in everything we do.
- We will absolutely respect the confidentiality of our working relationship.
- We will return your phone calls within 24 hours.
- We will meet the deadlines we set (and, in the case of extenuating circumstances outside our control, we will let you know well in advance of our dilemma).
- We will honor your right to know in advance our price for any assignment.

In order for us to meet our commitments and provide the highest level of service to you, we ask you to make the following commitments to us:

- You will do your best to accumulate your tax information in a timely and orderly manner.
- You will keep your appointment or give as much notice as possible if you need to reschedule.
- You understand that we will not schedule appointments between April 1 and April 15.
- You will try to avoid extensions when possible and you understand that if extensions are necessary due to your individual circumstances, additional charges may apply.
- You understand that one-half of your payment will be due upon receipt of your tax information and the rest is due upon delivery of your tax return. [*Author note: If you cannot yet bring yourself to commit to a fixed price or to collect money in advance say, “You will pay your account on a regular monthly basis, within seven days of receipt of our invoices.”*]
- You understand that if your current year invoice is not paid by December 31, 200X, the next year must be prepaid.

The team at [*Firm name*] fully believes that these commitments, on our part and yours, will enable us to provide you with the delightful and timely service that you look for in your tax preparation needs. And, if you are not absolutely delighted with our service, you, as the sole judge of our performance, have the right to withhold any payment. All we ask is that you honestly tell us where we have fallen short in your eyes so we can learn and improve from the experience.

We look forward to providing you with the highest level of service possible in the upcoming year!

The team at [*Firm name*]

P.S. We really like working with people like you! If you refer a client like yourself, you will receive a special gift and our highest regards. We really appreciate your business.

CHAPTER 5

HOW TO DISCUSS PRICES WITH CLIENTS

I mentioned in the “Introduction” that the number-one problem facing CPAs today is *attitude*. Nowhere is this situation more obvious than in the manner in which CPAs discuss their prices with clients.

Many CPAs have somehow gotten the idea that it is unprofessional to discuss prices with clients. Perhaps they think it gives clients the wrong impression that the CPA is primarily concerned with money. Yet no one wants to buy something with no idea of the price.

When you go into a store, who brings up the subject of price? The store. They do it by attaching price tags to everything. When you go to a gas station, who first mentions the price? The gas station. They post their prices on signs and on the pumps. When you are interested in buying a building, who starts the price negotiation? The seller does, by listing an asking price.

KEY POINT: If goods and services are being sold, the seller has the responsibility to mention the price first.

Even if the price will be subject to negotiation—such as real estate or used cars—the seller opens the negotiation with an asking price.

For people whose very language of business is money, CPAs demonstrate an amazing reluctance to discuss prices.

KEY POINT: Clients are embarrassed about discussing price. They are relieved if you bring up the subject.

If the CPA is also too embarrassed to discuss prices, a disaster could be waiting for both CPA and client.

KEY POINT: Clients accept value pricing better than most accountants do *if we* discuss the pricing with them ahead of time.

Whether you discuss prices or not, the client has some price in mind. It’s hard enough to meet a client’s expectations if you know them; it’s impossible if you don’t even know what price range they are considering. Therefore, it’s just good business to discuss price with clients before committing any firm resources to the project.

KEY POINT: I recommend you avoid the word *fee* when speaking to clients, prospects, and referral sources. Instead, say *price*. People sometimes perceive fees to be more negotiable than prices.

This chapter covers how to get off on the right foot with a new client, the client’s point of view when discussing price, guidelines on how to communicate price, and how to handle specific problems, such as objections and complaints.



TRAIN CLIENTS TO PAY YOU WELL AND PROMPTLY

KEY POINT: Clients will treat you the way you train them to treat you.

If you first meet with a new client, review your invoicing procedures and their payment procedures. Explain that you want to make it easy for them to pay their account. Find out whether your normal invoicing cycle fits well with their accounts payable processing. Most people seem to pay their invoices weekly or semimonthly, so, if you miss one payment cycle, you will catch the next one and still get paid before the end of the month.

Example: One firm normally invoices by the third workday of each month. They explain to clients that they expect to be paid before the end of that month. This way, if they prepare a list of accounts receivable at the end of any month, the client's name never appears. At the beginning of the month, the client's work is still in work-in-progress (WIP), by the end of the following month, it has been paid.

After explaining your policies to clients, ask them whether they foresee any problem complying. If so, you can adjust your invoicing cycle to meet their needs.

Then follow up. Observe when the client pays. If they pay you in accordance with your agreement, send them a note, the first time, thanking them for their business and for paying on time.

If the end of the month comes and you have not been paid, have your accounts receivable clerk call the client's accounts payable clerk to investigate. Perhaps your invoice was addressed to the wrong department or location. Perhaps there is some valid delay that can be remedied in the future. Don't personally make the call; that unnecessarily escalates the issue. Normally, as a senior-level executive in your firm, you should deal only with senior-level executives in the client organization.

Perhaps the client simply delayed paying you. You should get involved if your accounts receivable clerk hears about any problems from the accounts payable clerk. If this happens, again explain your policies to the client's senior-level executive and obtain his or her agreement to comply. If you let the delinquent payment slide, you may send the wrong message to the client.

Train the client with reward (the thank you note for prompt payment) or correction (the investigation of the late payment). They will get the idea.



WHAT "HOW MUCH IS THIS GOING TO COST?" REALLY MEANS

I can remember it vividly. I sat in the office of a prospective client. His walnut desk cost as much as my car. His paneled office looked like a moviemaker's idea of a bank president's office. I was a sole practitioner and he was a corporate president. We had just had a productive meeting discussing his audit requirements. Then, the inevitable other shoe dropped...

"How much is this going to cost?" he asked.

Many accountants get a tight feeling in their chests when they hear this question, some feel queasy, and a few even have physiological reactions when a client asks, “How much is this going to cost?”

All sorts of fearful scenarios can run through your mind. You might wonder, “If I quote an estimate \$100 too high, will he shop my price to other accountants?” If the questioner is a current client, you might wonder, “Doesn’t she trust me any more?”

“These fears cause accountants to lowball their prices. They make overly optimistic estimates of their costs to do a project. As a result, they underestimate the price. Sometimes they even lose money on a project. All because the client said, “How much is this going to cost?” and the accountant panicked.”¹

Sometimes accountants think a client who asks about price is price-sensitive. The assumption is, “Why else would they ask about cost?” But that is not always the case.

Don’t you want to know what something costs before you buy it? Clients are the same.

I once took my wife’s car to a trusted mechanic named Yale to get a window motor replaced. I didn’t ask, “How much will this cost?” Why not? Because Yale had done all the nonwarranty work on our cars for many years and we trusted him to charge us a fair price.

When I picked up the car, the invoice was about \$400. I groaned and asked, “Yale, what happened? Did you use a solid gold motor for the window? \$400! What’s going on here?”

Yale held his ground and explained the cost. So I paid him.

Why did I complain? Did I think Yale had ripped me off?

No.

The next time I took my car to Yale, there was a funny noise coming from the right front wheel.

“Yale,” I said, “How much is this going to cost?”

Why did I ask about the cost? Did it mean I no longer trusted Yale?

No, I trusted Yale.

Why, then, did I ask about cost this time when I did not ask before? Was it because the window repair invoice was higher than I expected?

No. That repair had actually cost just about what I anticipated.

Then why had I complained?

I complained about the price because it’s my job (as a customer) to keep Yale (as a supplier) on his toes. I wanted Yale to think I was price-sensitive even though I was not.

Do you have any clients like me? People who complain about your prices even though they are perfectly happy? I’ll bet you do. In fact, I’ll bet you yourself have been known to complain about a price or two even though you didn’t mean it.

¹ Cottle, David, *Professional’s Guide to Target Marketing: How to Gain Profitable New Business*. San Diego: Harcourt Professional Publishing, 2000, page 248.

KEY POINT: When you are the buyer, don't you try to buy at the lowest price? It is every consumer's job to buy what they buy at the lowest price. And some clients are very, very good at it. Clients are just like other customers....but they are often better negotiators.

The difference between these two incidents with Yale illustrates another important point in price discussions (and client relations).

In the instance of the broken window motor, *I knew what the problem was*. I also knew the approximate cost, I knew I could afford it, and I knew I intended to get it fixed.

But when a funny noise came from the right front wheel, *I did not know what the problem was*. It could have been something as simple as a tire out of balance, or it could have been as complicated as a broken axle. The cost could have been anywhere from a few dollars to over a thousand dollars.

So, why would anyone ask the cost, as I did? There are three possible reasons:²

1. One might want to know his or her options. For instance, was the problem with the right front wheel of my car covered by warranty? Should I have gone to the auto dealer or the tire dealer? If the problem was extremely serious, might I even trade the car instead of fixing it? Because I did not know, I asked, "How much is this going to cost?"
2. Someone might ask what the cost is to make sure they can write the check. Sometimes, they have to postpone expenditures until payday, or arrange to increase the credit line on their credit card, or make other arrangements. In other words, they want to be sure they can pay the invoice.
3. Asking, "How much is this going to cost?" signals the seller that the buyer does not have a blank check. It is a not-so-subtle indicator to the seller that, "I am not made of money. I am sensitive to cost. Do not try to take advantage of me."

KEY POINT: A buyer may ask about cost even though he or she has no idea how much a fair price is. They will ask just in the hope of appearing more knowledgeable.

So, I asked, "How much is this going to cost?"

Asking, "How much does this cost?" does not mean that the client intends to shop your price. It does not mean they don't trust you.

Stop worrying so much if clients ask the inevitable *how much* question. The balance of this chapter will give you several ideas of how to answer the question.

² Adapted with permission of Aspen Publishers, 2000, David W. Cottle, *Professional's Guide to Target Marketing: How to Gain Profitable New Business*, "How to Discuss Prices," page 249.



TURN A \$438 SALE INTO A \$238 SALE . . . WITHOUT REALLY TRYING

My wife wears designer glasses. They are made of a space-age plastic with rose tinting, fluted edges on the lenses, gold frames, and soft nose pieces. They are not cheap. A few years ago she needed new glasses. Here's what she told me when I came home from work:

I took my prescription to the same place I bought the previous pair. The salesclerk took my order for all the options and said, "That will be \$438."

I told her, "That's more than I wanted to pay."

"Well," the clerk said, "Let me see what I can do." And she went into the back. A few minutes later she returned. "We've got one or two of your features such as the rose tinting on a special right now." She refigured the order. "That will be \$300."

I thought I could do better. "See these glasses I'm wearing right now? I bought them here just two years ago. They are very similar to the ones I want now, and I paid only \$200 for them."

The clerk considered for a moment. "We had the invisible bifocals on sale last week. Maybe I can get the manager to extend the sale price." Again she disappeared to the back of the store. She returned with this offer. "I can give you last week's sale price. That will be \$238."

I bought the glasses and saved \$200.

Let's look at what happened here:

- The salesclerk quoted a \$438 price.
- My wife asked her to reduce it.
- The salesclerk quoted a \$300 price.
- My wife asked her to reduce it.
- The salesclerk quoted a \$238 price.
- My wife took it.

My friends jokingly call my wife the Director of Consumer Affairs because she always gets the best bargains.

Note that my wife never said *no* to a single price the salesclerk quoted. She never said she could get it cheaper elsewhere. She never threatened to take her business elsewhere. She never even said the price was too high! She said "I'd like to pay less," and the clerk agreed.

Do you have clients like my wife?

What should the clerk have done? What should *you* do if a client asks for a lower price?

When my wife said she wanted to pay less, the clerk could have asked, "Which of the features you have chosen should I eliminate?" You could do the same—offer to cut back certain of the services the client has requested.

If the clerk had offered to delete some features, my wife would have told her she wanted all the features but didn't want to pay full price. The clerk could have told her how wonderful all those features were and reminded her how nice the glasses look on her. My wife would have paid the \$438.

But the clerk was really more of an order-taker than a true salesperson.

If a client says he or she wants all the services but thinks the price is too high, try saying this:

I'm fortunate. Given my financial position, I do not need your money. But that is not as relevant as the fact that you need this service. It will help you achieve your financial goals [*or other appropriate wording*] and sleep better at night knowing that you are taking the right steps to secure your financial future.

My experience has been that when you really need something, you are going to pay for it whether you buy it or not. And it will usually cost you more and be more painful if you don't buy it.

A couple of years ago I went to a different store to buy glasses. As the salesclerk described each feature and I selected it, I protested the price of each and every one. But the salesclerk told me how wonderful the nonreflective lenses are for a public speaker like me because the audience can see my eyes better through the lenses. She did that for each feature. She did not budge on the price.

The total came to \$423. In a last-ditch attempt, I asked for a discount. "Let me go ask the manager," she said. The salesclerk went to the back. She returned with a 10 percent discount.

As we left the store, I said to my wife, "I just made \$42."

Do you have any clients like me?

KEY POINT: The problem with most accountants is that we give discounts to people who don't even ask for them.

A chartered accountant in Coventry, England, obtained a new client who owned a small business. He described the situation as follows:

The records she brought me were a mess. It was as if she had brought in a sack of turkey feathers and asked me to turn it into a whole bird. When I finished, my time charges at standard came to £700. I looked at that amount and panicked. I told myself she would never accept a fee that high. So I only charged her £330. Listening to you, I kick myself because now that client thinks she can bring me that same mess this year and pay only £330.

The countermeasure was right in front of the accountant: All he had to do was discuss the price with the client either as soon as he saw the mess and before investing £700 of time, or even after he did the work but before he delivered the product and the invoice.

But he was embarrassed to even discuss the price with the client. He gave her a huge discount that she didn't even request.



DO NOT MAKE IT LOOK TOO EASY

Don't be modest. If you don't toot your own horn, there will be no music. Do not adopt an attitude that says, "Aw, shucks! It was nothing." If someone praises you, look them in the eye and say, "Thank you. I'm glad I could help."

A British chartered accountant was once the controller of a Dutch manufacturer. He told me:

We had this very expensive machine that applied microscopic amounts of gold to electronic parts. The machine malfunctioned and began to deposit too much gold. We contacted the manufacturer who sent their engineers to look at it. They couldn't fix it. They said the machine had reached the end of its useful life and should be replaced with a new one for \$800,000.

We were about to order the new machine when one of our engineers suggested we contact a German engineer who supposedly could work miracles.

He came all the way to Amsterdam. He studied the machine blueprints, he observed the machine in operation for a few minutes.

Then he reached into his bag and removed a spanner [*the British word for an open-ended wrench*]. He reached into the machine and banged on a part with the spanner. He looked up and said, "I think it will work now. You monitor it for 30 days. If it works for 30 days, we will assume it is fixed. If not, I'll come back."

Thirty days later the machine was still working and the German engineer sent an invoice for \$150,000.

The president of my company was upset and called the engineer to complain. The engineer asked, "Your people could not fix it, right?... The manufacturer could not fix it, right?... You planned to spend \$800,000 on a new machine, right?" My president reluctantly said this was all true. "Then I think \$150,000 is a very fair price."

My president objected, "But I can't justify paying you \$150,000 for one day's work!"

"Oh, well, if that's your problem, you don't have a problem," answered the engineer. "You are not paying me for one day's work. You are paying me for 20 years of experience."

The president paid the invoice.

The engineer made it look too easy. By the same token, ask yourself, if this engineer was an accountant, how much time would he charge? Would he charge the time it took him to travel to the airport to depart on this assignment? How about the actual flying time? And the time spent traveling from Amsterdam's Schiphol Airport to the plant? Would he charge for the time he spent studying the machine's blueprints? Or just the 10 seconds it took him to pick up the spanner and adjust the machine?



YOUR PRICING COMMUNICATES YOUR VALUE

A couple of years ago, a managing partner of a CPA firm called me from Seattle. His firm needed to improve their partner compensation method. As I always do, I asked how he had heard about me.

“You spoke at an AICPA conference in Seattle a few years ago. One of my partners and I attended, and we were impressed.”

“Thanks, but why call me now?”

“We need a new partner compensation method, and I saw your name in an article in the *CPA Marketing Report* about practice management consultants.”

I had seen the article and it contained a two-page list of over a dozen consultants and particulars about them, including prices. “Why did you call me instead of one of the other consultants?” I asked.

“You were the most expensive, and we want the best.”

That managing partner equated *price* with *value*. And he is not alone.

KEY POINT: Most people equate high prices with quality, especially if they have little else by which to judge value.

If you price your services at the low end of the market, clients won't take you seriously. If you are expensive, not only will they respect you, they are more likely to implement your recommendations because they paid so much for them.

When I first went into practice, John Reid, a very successful CPA in Dallas, taught me to answer the question, “How much do you charge?” by saying:

We are as expensive as anyone, and our clients think we are worth it.

KEY POINT: The more people pay for something, the more valuable it is.

Naturally, you should always discuss price before you perform a service. This is not only common courtesy; it is also good business. You have greater leverage with a client before you perform a service because the client wants something from you (a solution to a problem). After you perform the service, the client has greater leverage because you want something from the client (money).

One important factor affecting the client's perception of your value is your own attitude toward your prices. Just as some animals can “smell fear,” clients can often sense if you are uncomfortable with your own prices. They observe—often unconsciously—your tone of voice, the words you choose, the loudness of your voice, your body language, even your breathing. If you are ambivalent or wishy-washy, a good negotiator will sense that and press the advantage to lower your prices.

On the other hand, if you are comfortable with your value and your prices, clients will also sense that and they, too, will feel confidence in your value. I learned this simple truth from one of my own clients.

KEY POINT: What you say with *confidence*, they will believe!

Most clients will pay a fair price. They are chiefly concerned that other clients pay comparable prices. Clients periodically need reassurance that the firm charges all its clients fairly—maybe not cheaply, but fairly. Be aware that if you offer a discount to one client without a very good reason, other clients are likely to find out and want a similar discount.



HOW TO USE “COTTLE’S LAW” AND “COTTLE’S COROLLARY”

Clients come to you with problems. To the clients they may be big or small problems.

KEY POINT: A client’s problem is always bigger to the client than it is to you.

That is precisely why they come to you: You can do something that they cannot.

Unfortunately, many accountants have a knee-jerk reaction: They pooh-pooh the client’s problem. They say, “Don’t worry about it. It’s no big deal; we handle difficulties like this all the time. It won’t be too hard for us to handle it.”

KEY POINT: If you minimize the size of the problem, you minimize the value of your solution.

Can you remember a time when an accountant you know minimized a client problem? The accountant has just shot himself or herself in the foot. And then wondered why the client complained about the price.

Clients come to you with what to them constitutes an *A problem*—a B-I-G PROBLEM! Picture the client as a king or queen who envisions this problem as a fearsome, fire-breathing dragon plundering his or her peaceful kingdom. The monarch appeals to you, their knight in shining armor, to slay the dragon and restore tranquility. Some accountants tell the client that the *A-problem* dragon they saw pillaging the kingdom isn’t really a dragon, it’s only a *B-problem* coyote! And some accountants will even tell the client that the situation is only a *C-problem* mouse!

KEY POINT: Knights earn more for slaying dragons than coyotes. And I might repeat what I said earlier: Gunfighters don’t get paid by the bullet!

Certainly you should not overstate the problem, nor should you make clients worry needlessly about trivial matters. But even the routine services of a highly skilled professional are extremely valuable to clients. Don’t minimize your value by minimizing the problem.

Why do some CPAs paint themselves into a corner, minimizing their own value by minimizing the problem?

They do it because they want to ease the suffering of their clients. Humans naturally want to comfort the suffering of even complete strangers. So it’s no wonder you feel that way about sufferers who are your friends and clients.

The problem is that if you do alleviate suffering by minimizing the client's problem, you also downgrade the client's perception of the value of your contribution.

KEY POINT: *Cottle's Law*—The value of the solution varies with the size of the problem.

The bigger the problem, the more the client will pay to solve it. So, never minimize the problem. Don't exaggerate it either. But if the client sees their problem as a big one, don't argue. Remember the following key point:

KEY POINT: *Cottle's Corollary*—The bigger the problem, the more valuable the solution.

Yes, it's okay to make clients feel better. But don't do it at the cost of losing your fee. There is a way to make clients feel better without minimizing your own contribution.

Build up the value of your contribution instead of minimizing the client's problem. Your position is, "Yes, you've got a serious problem here. But we have lots of talent in the firm and I'm confident that we can solve your problem, or at least mitigate some of the damage by applying some of our firm's talents. Yes, it will cost you some money, but that's what money is for."

With some problems, if the client asks, "How much is this going to cost?" You can answer:

If we get a few breaks ... maybe *nothing!* It's possible that the tax savings [*or other outcome*] may be more than our fee. In other words, we may be able to pay for our services by the savings we will generate for you.

This answer also has the advantage of placing the client's attention squarely on the results you will obtain, not on the price you will charge.



THE PROBLEM WITH PRICE ESTIMATES³

Price estimates are just that, but accountants often fail to communicate that to clients. Clients are given the impression that an estimate is a fixed price even though that was not what was intended. Even a regular client, who understands that your quote is only an estimate, will eventually lose confidence if the final prices consistently exceed the estimates.

Accountants are usually better off estimating a project on the high side and then giving the client a pleasant surprise. Then they will learn that the estimate is usually a worst case.

The danger, especially with new clients, is that a high estimate will, in fact, prompt them to shop your price. So, they never become regular clients.

To prevent this, accountants should give the estimate as a range, carefully explain all the variables, and explain to the client what he or she can do to help keep the price low.

³ *Ibid.*, page 250.



HOW TO AVOID PROFESSIONAL PANIC

Some accountants get panicked by what the lowest 10 percent of the market does.

Example: A North Carolina firm I worked with was typical. When I interviewed one of their managers, she said, “I hope you don’t recommend we raise fees. All my clients are complaining about our fees already.”

So I asked her, “Debbie, how many clients do you work with in the course of a year?”

“I don’t know.”

“Could it be as many as 100?”

“Oh, I’m sure it’s more than that.”

“Okay. Could it be 200?”

“No, I think it is more like 150.”

“Good. Now, of the 150 clients whom you worked with in the last 12 months, how many actually complained about your prices. And when I say ‘complain,’ I do not mean that they commented that you charged more this year. That’s not a complaint, that’s a comment. I mean how many said something like, ‘I don’t know whether you are worth it,’ or ‘That seems too high in relation to what you did?’”

Debbie looked up at the ceiling in thought. I remained silent as she searched her memory. In a few moments, she laughed and looked back at me. “About 10 or 12.”

“So less than 10 percent of your clients actually complained?”

“That’s right.”

Like Debbie, many accountants are unduly influenced by the often idle complaints or comments of a small number of clients. Yet, since you almost never hear clients tell you to raise prices, the only comments you hear are negative.

Yet the fact remains that the vast majority of your clients are perfectly happy with your prices. Remember that over 90 percent of them come back year after year. Many of my clients report over 95-percent client retention each year.

So, first ask yourself, “How many of my clients *really* complain?” If you are like most firms, it is far less than 10 percent, probably less than 5 percent.

Yet many accountants let this lowest 5 or 10 percent of their practice dominate the entire firm. They set their prices, service standards, and collection policies in a futile attempt to satisfy their least desirable clients.

Indeed, there are commodity clients—although calling them *shoppers* or perhaps *customers* is more appropriate. These consumers buy based on price *no matter what*. Quality means nothing to them.

These commodity shoppers are probably a small part of the market for your services. They may be 2 percent or 10 percent; no one knows. The size of this market segment changes according to economic conditions and competition, including the competition from nonaccountants.

If these shoppers become active and start to solicit bids for accounting services, it drives some CPAs crazy! They think the whole market is shot and the game is lost. All it takes is one significant client or prospect lost because of a price estimate that was too high. Some accountants then come to believe that price is the only variable.

Whatever the reason, some firms then panic and go after the real bottom end of the market. True, an accounting practice can cover a fairly wide market. Nevertheless, it cannot cover the equivalent of the Chevy Geo on the one end and Rolls-Royce on the other.

KEY POINT: Focus on the 90-plus percent of clients who are happy with your prices and your service. You never hear from them about how reasonable they think your prices are, so you often forget they are there.

So, make sure it is a complaint and not a comment. People often make comments about prices that are not really complaints. If someone says a Ferrari is expensive, that isn't a complaint; it's a comment. Just because a client comments that he or she was charged more this year or this month than last doesn't mean the client is dissatisfied; it just means that he or she noticed.

The only reason some clients pay such close attention to our chargeable hours is because accountants train them to; if we price by the hour, we make it the client's *job* to focus on hours.

Also, don't use the words "cost" or "expense" to describe your fees. Call it the client's "investment" as in, "Your investment for this service will be \$_____."



ASK FOR A DEPOSIT

Always ask for a deposit from a new client as an evidence of his or her commitment to the relationship. If clients are unwilling to pay a portion of your price *before* the service, he or she may be unwilling to pay *after* the service. A deposit requirement also serves as part of the screening process for new clients. You can, for instance, say this:

We normally get a deposit of 50 percent of the estimated price from new clients before we begin work.

Then pause for the clients' reaction. Remain silent and see their response. Many will nod or reach for their checkbooks. Note that you haven't *required* the deposit. You have not issued an ultimatum. Nor have you specifically told that client that you want a deposit. You have quietly stated your normal terms and invited the new client to comply. If the client is noncommittal, continue by saying:

In your case, that would be about \$_____.

Again pause for the client's reaction.



BE FLEXIBLE⁴

Be flexible in your terms and make it easy to buy. For instance, it's okay to take credit cards. Most clients who engage you don't have cash-flow problems, but occasionally one will have a problem with a deposit you request to confirm your engagement. If your due diligence discloses no other problems with the client, you should accommodate him or her. As long as your clients pay the agreed price for your yearly services over the year you deliver them, I don't see a problem.

For instance, if you are negotiating with a retailer who is cash-poor in a particular season, they may prefer to match their payments to their cash flow. Some people prefer to pay weekly, some monthly, some quarterly, depending on when their customers pay them. Naturally, you have to make allowances for the imputed interest in such customized arrangements.



THE PREFERRED CLIENT APPROACH⁵

Offer a new client the option to be a *preferred client*. Under this arrangement, they agree to pay you within seven days of your invoice and refer at least one qualified prospect to you per year.

In return, you commit to give them seven-day turnaround on all routine work, return all telephone calls within one business day, and guarantee 100-percent satisfaction.



FIVE IMPORTANT TOOLS IN NEGOTIATING PRICES⁶

The following are six important tools in negotiating prices:

1. Recognize Who Initiated the Negotiation?

If the client called you, you have more leverage in negotiating your price. If you found the opportunity and approached the client with it, you may have less leverage, especially if the client thinks you only called him or her because it was the off season and you had nothing better to do.

⁴ *Ibid.*, page 249.

⁵ *Ibid.*, page 250.

⁶ *Ibid.*, pages 247-248.

2. Understand the Anchor Effect

Using shortcuts (such as standard chargeout rates) creates problems in decisionmaking. They make the following observation about making decisions, such as how much to invoice:

Most people, consciously or unconsciously, start with a number that comes easily to mind. Then they adjust up or down to reflect other significant facts. This procedure seems sensible, but it suffers from a major defect: *people usually adjust insufficiently*. The initial number (i.e., the anchor) powerfully affects the analyst's mind and keeps the final judgment from moving as far as it should. [*emphasis in the original*]⁷

I have tested the anchor effect with accountants on more than a dozen occasions. See Exhibit 5-1, "Sample 'How Would You Price This?' Quiz." I give seminar participants hypothetical facts on an engagement. I include what the accountant did, which personnel worked the engagement, their compensation, and the number of hours they required. All facts are identical. The fact sheets also say, "The standard charge for the engagement is \$_____." Half the sheets show the standard charge as \$4,042.25 and half as \$5,622.25.

In every test, in both the United States and the United Kingdom (for which the amount has been converted to pounds), the randomly chosen half of the audience that saw the higher standard charge figure gave a proposed invoice significantly higher than the half that saw the lower figure.

Let's relate this to the real world.

The following story is almost too good to be true, but I swear this is the truth, the whole truth, and nothing but the truth, as told to me by Jim himself.

Dave, when I finished getting my certified financial planner (CFP) designation, I reviewed my clients' Forms 1040 for dividend and interest incomes.

I identified a client who needed estate planning. They were an elderly couple with a potential \$400,000 estate tax liability when the second spouse died. Setting up an A-B Trust would protect both clients' estates.

When I met with the clients to discuss my recommendations, the husband was delighted at the savings. "You mean that we can save \$400,000 in estate taxes and pass that on to our kids?"

When I told them yes, they were naturally delighted with the results we were getting for them. The husband said, "I'll bet you're going to charge us a pretty penny for this, aren't you?"

I laughed, "Well, it will certainly help pay my daughter's tuition this semester."

⁷ Russo, J. Edward, and Paul L. H. Schoemaker. *Decision Traps: The Ten Barriers to Effective Decision-Making and How to Overcome Them*. New York: Simon & Schuster, 1989, page 87.

The husband asked me, “How much is your daughter’s tuition?”

I told him, “\$15,000.” Later, I added up my time charges at standard. They came to just \$750. I felt guilty charging more than that and I discussed it with my wife.

She asked me, “How long did it take you to get your CFP designation?” Of course, being a CPA, I knew it had taken 400 hours. She asked me, “Who will pay for that time?” So I felt better about taking a sizable write-up. Being a long-time disciple of yours, Dave, I wrote my standard charges up \$1,000.

I prepared the invoice for \$1,750 and enclosed it with our report in an envelope for the client to pick up at my office. I was at lunch with another client when the husband came by to pick up our report for his attorney. The client opened the invoice and said to my receptionist, “I think you made a mistake on the bill. I think you left off a zero.”

Dave, I learned a valuable lesson here: Never forget anything you tell me.

What happened here? Why had Jim undercharged the client by more than \$13,000?

The client focused on the benefit (rather than the cost), anchored on the \$15,000 tuition (as “a number that comes easily to mind”) and expected an invoice for about that amount, so naturally he thought \$1,750 was supposed to be \$17,500.

But we CPAs often know “the cost of everything and the value of nothing.” Unfortunately, Jim was blinded by the left side of the cost (rather than the benefit). He anchored on \$750 as “a number that comes easily to mind,” and it dragged down his estimate of a fair price. He thought he was “adjusting up or down to reflect other significant facts,” but, as Russo and Schoemaker said, “people usually adjust insufficiently.” And that’s what Jim did.

Why did the husband focus on college tuition? It has nothing to do with estate taxes. It doesn’t matter. According to Russo and Schoemaker, any number will do for an anchor, even a random one!

3. Ask “How Much Have You Budgeted to Solve This Problem?”

When a client approaches you with an unusual problem, ask, “How much have you budgeted to solve this problem?”

The real answer to this question is, “Huh? Budget? What budget?”

This technique is simply a clever way to ask the client how much he or she thinks the solution is worth. Value is in the eyes of the client. If he or she sees \$1,000 of value for a job that will cost \$15,000 to do, better find out before you do the job.

Likewise, if the client tells you he or she will pay \$20,000 to solve a problem, you know the client wants your very best efforts and is willing to pay for them.

4. Ask “If I Can [*whatever the engagement is, such as ‘pull this off,’ or ‘reduce the taxes,’ or ‘get you more than your current asking price for your business’*], How Much of the Savings/Extra Money/etc. Are You Willing to Split With Me?”

When I say the word *split*, what amount comes immediately to mind?

That’s right—50 percent.

The anchor effect then kicks in to raise the client’s sights. The client might suggest 10 percent or more, and often the whole 50 percent, depending on the type of engagement.

One of my clients told me this story:

A client of many years approached me for advice about selling his business. I asked him how much he wanted for it.

“\$1,600,000,” he answered.

He was not only a very good client, he was a very good friend, so I told him, “You dummy; your business is worth a lot more than that.”

“Well, if you can get me more than \$1,600,000, I’ll split the difference with you,” he offered.

I worked the deal for a few months and got him \$3,200,000 for his business. As we drove away from the closing, he said, “Who would have thought a few months ago that I would get \$1,600,000 more for my business than I thought it was worth?”

I answered, “You didn’t get it. I did. And you owe me \$800,000.”

“You’re right,” the client answered.

5. Relate the Price to the Amounts Involved

The following is a true story of an accountant who created extraordinary value and received an extraordinary fee.

Example: Alan Accountant has a well-deserved reputation for serving companies in the widget industry. Evelyn, an executive of Ace Widgets, one of Alan’s clients, approached him with a problem. Evelyn earned a high salary at Ace Widgets, but she didn’t own any equity in the company. Evelyn wanted to go into business for herself and buy Champion Widgets, a noncompeting company. Evelyn could buy Champion for \$50 million, but had little capital. She asked Alan to help raise the money for a leveraged buyout of Champion. Alan obtained permission from Ace Widgets to help Evelyn.

Using his extensive contacts in the widget industry and the financial community, Alan put the deal together.

The attorney drawing up the papers called Alan and said, “I’m making up the schedule for the disbursement of proceeds. I need to know how much your fee will be on the Champion Widgets deal.”

Alan referred to his WIP report from his time-keeping system and learned he had invested \$35,000 so far in the engagement at standard chargeout rates. Because of his

unique skills, Alan realized that the deal would not have occurred without his efforts. Inspired, he told the attorney: “One-quarter of one percent.” That is \$125,000.

And Alan did, in fact, invoice \$125,000 plus \$10,000 for disbursements for the engagement.

As I mentioned earlier, it’s only logical that fees should directly relate to the value of the service performed.

By quoting his fee as a percent of the amounts involved, the client could see that the fee was, quite literally, immaterial.

Example: Shortly after the previous transaction, Paul, the president of Ace Widgets, called. “Alan, I heard that Wonderful Widget Company is available. I can buy it for \$160 million. I need you to help us raise the money.”

Again, using his extraordinary skills and contacts, Alan succeeded in putting together a bank-financing package for Ace to buy Wonderful.

The bank’s attorney, putting together the disbursement of loan proceeds called Alan. “How much is your fee going to be?”

This deal was more complex and Alan had invested \$80,000 at standard rates. Again, Alan replied, “One-quarter of one percent.”

The bank’s attorney asked, “Alan, that seems a little high. Has Paul approved this?”

“No,” Alan answered. “I hadn’t even thought about the fee until you asked.”

“You’d better run it by Paul because he’s the one borrowing the money. If it’s okay with him, it’s okay with the bank.”

Alan called Paul and said, “I’ve got good news. The bank’s attorney is drawing up the final papers for your loan. She wanted to know how much my fee was and I told her one-quarter of one percent. She said that was okay with her if it’s okay with you.”

“Well,” Paul answered, “If it’s okay with the bank, it’s okay with me.”

Shortly after that conversation, the deal developed a glitch that required Alan’s skill to repair. Alan felt that—since the client had already approved a \$400,000 fee for the work he had already done, this extra work deserved an extra charge. Alan’s final standard fees were \$130,000. He invoiced \$420,000 plus \$30,000 in disbursements—a \$320,000 write-up.

It’s instructive to consider that Alan’s standard chargeout rate at that time exceeded \$600 per hour, and this was in the early 1990s. By the way, Alan’s story is true with some details altered to shield his identity. The relative amounts are factual and the actual amounts were even larger than those in the example.

Occasionally, a client comes to you with a problem that allows you to answer the *how much* question like this:

I cannot guarantee this ... but with a little bit of luck ... maybe it won’t cost you anything. We *may* be able to reduce your taxes [or whatever] by more than the amount of our fee.

The beautiful thing about this approach is that it places the client's attention directly on the outcome rather than the cost.



HOW TO HANDLE PRICE OBJECTIONS

The first problem with selling **value-added services (VAS)** is that clients have to pay your fee immediately while the benefit comes in the future, sometimes years in the future with estate planning, financial planning, and retirement planning. They see a short-term pain for a long-term gain. So clients may say, "Five thousand dollars! That's a lot of money! Can you do it for less?"

KEY POINT: Never sell on price or cut your fee. Once you do that, they will never be good clients.

Instead, just ask them:

Do you know what it will cost you if you *don't* do it?

For estate planning, you may joke that it won't cost *them* anything; it will cost their *kids*.

If the client continues to object, say this:

Our fee is a minor investment compared to what you can save [*or make or gain*].

This again places their attention on results instead of the cost.

Then, go into what they will gain, depending on the nature of the engagement. Whether the service will be succession planning, retirement planning, a new accounting system, or whatever, you should paint a vivid picture for the client of how rosy the future can be if they solve this problem.

Alternatively, you might also paint a picture of how bad it could be if they do not solve the problem.

Keep them thinking about what they will gain or save, not about your price.

For tax or estate planning, you can always use the following old jape:

Who do you love more? Your children or your uncle?

If that doesn't ring the bell with them, explain that you mean *Uncle Sam!*

If you neglect tax planning, it's like saying you would rather the IRS get your money than yourself or your own children and grandchildren.



HOW TO HANDLE PROCRASTINATORS

Some clients hate to make decisions. They will say, "I have to study the issue and sleep on it before I make a decision," or "It's the holidays. I'll do it later," or "I'm leaving on vacation in six weeks. Let's talk about it when I get back."

Say this:

If anything happens to you between now and then, I would hate myself for letting you delay. Changes in your circumstances could foreclose some options you now have; they would no longer be available. The longer you wait, the more risk you take that you will be left with fewer choices. You may lose a key employee, your building could catch fire, you could become uninsurable, you might get disabled. Who knows what the future holds? You will sleep better at night once you handle this. Do it now.



HOW TO HANDLE PRICE COMPLAINTS

So what about the real complaints?

When I was first in the practice of public accounting, one of my mentors was Dave Powell. I once asked Dave how to handle price complaints, and he told me this story:

Last week I delivered a financial statement to one of my clients along with a bill for the service. The client took one look at the invoice and said, “Your fee is too high.”

Most accountants are spring-loaded in a defensive posture. Touch them anywhere and they withdraw into their defensive shell—especially when it comes to their prices. Thus, typically, if a client questions an accountant’s invoice, he or she will immediately reach into his or her briefcase, pull out the time run, and wave it under the client’s nose, exclaiming, “I even wrote it down!”

Not me. I’m not at all defensive about my prices. I’m worth every penny I charge and more. If a client says my invoice is too high, I do not try to justify it. Instead, I turn it around.

I look the client in the eye. I smile in a friendly and confident manner. And I ask him, “Why do you think the price is too high?” You see, I am putting the shoe on the other foot. Now he or she is on the defense, not me.

He hems and haws and stutters and stammers for a bit. Finally he says, “It just seems too high.”

So I reply, “Well, it’s not.”

And that is the end of the price discussion.

Dave Powell had encountered what I call the *pro forma complaint*. It’s not a real complaint. The client thinks, “Who knows? Maybe the accountant will lower the price. It cannot hurt to ask. He or she sure can’t raise it any more.”

For real complaints, you should still ask Dave Powell’s question, “Why do you think it is too high?” Nine out of ten times, if a client does complain about a price, the price is not the real problem. The problem is some aspect of the service such as a late report, a telephone call not returned, an appointment missed, and so forth. But the client doesn’t know how to articulate his or her real complaint and so the price becomes the focus.

If you ask *why*, you can find out the real problem. Then you can handle it, as the following example shows:

Example: A client is contemplating a \$1 million transaction that can have significant tax ramifications if not handled correctly. You suggest that you want to research the tax treatment to see whether there might be a more tax-favored way to do the deal. After \$2,000 of research, you discover it doesn't matter. You charge the client \$2,000 and she complains.

You ask, "Why do you think the price is too high?"

Her response: "You didn't find anything, so the research has no value."

The real problem here, of course, is that *you did not discuss the price and the possible outcomes with the client before you did the work*. Let's suppose you succumbed to the myth of, "Do the work first and worry about the price later." So you are in trouble.

Here's how to handle that:

Yes, we didn't find anything. But that is also valuable. Think of the research like an insurance policy. At the end of the year, if your house didn't burn down, do you think the insurance was a waste of money? Of course not. We invested this \$2,000 to protect your \$1 million investment in this transaction from adverse tax consequences.

If that doesn't do the trick, you can add:

Evaluate us over one to two years. We may not be worth what we charge every single month. Some months, we may be worth many times what we charge. Our goal as a firm is to be worth three times what we cost. Sometimes it's easy to measure our value in reduced taxes, increased profits, reduced costs, and so forth. Sometimes our value lies in peace of mind. And who can put a price on that? Yet our goal is, year in and year out, to be worth three times what we charge. I think that if you look back over the last few years [*here, you can remind him or her of several great outcomes in the past*], you will agree that we are well worth what we charge.

If that doesn't do it, say, "Then you don't have to pay." And make sure you remember, next time, to discuss prices before you do any more work for that or any other client.

EXHIBIT 5-1: SAMPLE “HOW WOULD YOU PRICE THIS?” QUIZ

The following two versions of the form, “How Would You Price This?” can be used to test the anchor effect in your firm. The first form indicates that the standard fee produced by your time-keeping system for the sample engagement is \$4,042.25. The next page indicates that the standard fee is \$5,622.25. The remainder of each page is identical.

How Would You Price This?

Assume you are doing annual reviewed financial statements and tax returns for a privately held company. You have been doing work for this client for several years, and this engagement is similar to that of previous years. The client has two people in the office, namely, a competent full-charge bookkeeper and an assistant.

The standard fee for the engagement is \$4,042.25.

Based on these facts, compute the amount of the invoice at the end of the engagement.

<i>Description</i>	<i>Annual Compensation</i>	<i>Billing Rate</i>	<i>Hours</i>	<i>Amount</i>
Owner	\$90,000	\$	10	\$
In-charge (three years’ experience, certified)	42,000	\$	20	
Staff assistant (eighteen months’ experience, noncertified)	37,500	\$	20	
Typing and checking 100 photocopies	22,000	\$	10	
Mailing reports and returns				\$12.25
TOTAL PROPOSED BILLING				

How Would You Price This?

Assume you are doing annual reviewed financial statements and tax returns for a privately held company. You have been doing work for this client for several years, and the engagement is similar to that of previous years. The client has two people in the office, namely, a competent full-charge bookkeeper and an assistant.

The standard fee for the engagement is \$5,622.25.

Based on these facts, compute the amount of the invoice at the end of the engagement.

<i>Description</i>	<i>Annual Compensation</i>	<i>Billing Rate</i>	<i>Hours</i>	<i>Amount</i>
Owner	\$90,000	\$	10	\$
In-charge (three years' experience, certified)	42,000	\$	20	
Staff assistant (eighteen months' experience, noncertified)	37,500	\$	20	
Typing and checking	22,000	\$	10	
100 photocopies				
Mailing reports and returns				\$12.25
TOTAL PROPOSED BILLING				

CHAPTER 6

BUILD A BETTER FIRM WITH BETTER CLIENTS

Every good salesperson will tell you that the first thing to do is qualify the buyer. A real estate salesperson would be wasting time showing million-dollar houses to someone who could not afford one.

The same principle applies to accounting practices. Is the client both able and willing to pay a fair price? Would the client recognize a fair price if he or she sees one? Or will they constantly pressure you to lower prices?

It's easier to build a good firm if you have good clients. And it's much easier to work with, invoice, and collect from a good client than a not-so-good client. It's more fun, too.

You can save yourself a lot of grief if, early in the discussion with each prospect, you politely communicate the message that, "We will not be the cheapest CPA firm you talk to. In fact, we are rather expensive. If you are interested in low prices more than good service, let me know now so we can both save time."

This chapter shows you how to evaluate your clients and how to fire or upgrade your worst clients.



WHY ARE YOU IN BUSINESS ANYWAY?

If you're like most accountants, your goals for your clients go far beyond the mandatory services of keeping them in compliance with tax laws and reporting on financial statements. In fact, I recommend my clients use an integrated approach to marketing and delivering a full range of financial *supermarket* services I call *four-dimensional client service*. This enables CPAs to guide their clients to achieve a more comfortable current lifestyle, a financially secure retirement, and the transfer of the maximum of their accumulated wealth to their heirs and favorite charities.

And you don't have to be a big firm to provide a full range of services. You can use strategic alliances with other professionals. Thus, even the smallest practitioner can benefit from the financial *supermarket* approach.

Every firm should consider, "Why do people come to you? What do you do for them? What is your mission?"

Here are some mission statements some of my clients use:

- [*Firm name*]'s mission is to assist its clients to identify, clarify, and achieve their goals. We accomplish this by caring about our clients' companies as if they were our own.
- OUR MISSION—To listen to our clients, identify their needs, and provide creative solutions.

- We provide financial solutions and peace of mind for life.
- Our purpose is to guide clients throughout their financial lives.
- [*Firm name*] Mission—To help our clients build and retain wealth. We help owner-managed businesses and successful individuals increase their current income, build a secure retirement, and pass maximum wealth to the next generation.

Let's assume that you—like my clients above—want to do more for your clients than just routine services. Let's just pick a mission statement that should fit most of the readers of this book:

Our mission is to help our clients build a bridge to a better future.

Let's see how many of the following statements apply to some of your clients:

- Some people don't want a better future. They never really think beyond their next paycheck.
- Some people may wish for a better future, but they won't do anything to get there. They know they have self-destructive habits, but they choose not to change them.
- Some people are not willing to pay for help in reaching their goals. They want something for nothing.

Fortunately, it is a small number of clients who cause you grief. If your goal is to maximize *revenues*, then you put up with it. But if your goal is to enjoy your practice and maximize your service to your good clients (and, as a result, your *profits* on a long-term basis), you will discard your worst clients each year. Some accountants review their clients in terms of the hassle factor and costs that were not included in the original agreement, and either renegotiate or terminate the relationships. One financial planner and investment manager has an explicit policy to get rid of the worst 10 percent of his clients each year.

In fact, you probably have several clients that, when you think about them at all, you say to yourself, "If I had known then what I know now, I would never have gotten involved with them."

Let's talk about how to know ahead of time what you should know about potentially troublesome clients so you can avoid them in the first place.



HOW TO RECOGNIZE A GOOD CLIENT

The man who chases two rabbits catches neither.—Confucius

Arsenio Hall once asked Bill Cosby for his secret to success. Bill replied, "I can't tell you a sure way to be successful. I can tell you that the sure way to fail is trying to please everybody."

What makes a good client? It is important to define what makes a good client for your firm. The three steps below can help:

-
- Step 1.** Consider your own standards in the following areas (add any areas you think are relevant):
- Amount of annual purchases
 - Promptness of payment
 - Growth potential
 - Referral potential
 - Actual referrals
 - Profitability of serving client (Write-downs and write-ups)
 - Risk of litigation or damage to your reputation
 - Fiscal year
 - Fun to work with
 - Asks your advice when they should
 - Takes your advice when you give it
 - Other items you think relevant
- Step 2.** The best way to grow is to “clone” your best clients. Look at your ten best clients. What characteristics do they have in common? List them.
- Step 3.** What makes a not-so-good client? Consider the above items and any others you think are relevant.
-

Now you should have a clear definition of what to look for and what to avoid in future clients. It is likely that 80 percent of your clients provide 150 percent of your profits. This statement appears oxymoronic at first, but actually means that a small minority of clients (20 percent or less) can hold the firm back and the firm might earn more profit without them. One firm I work with, which had less than 10 full-time equivalent (FTE) personnel when we started, had revenue for the previous 12 months from more than 180 corporate clients of \$685,000. The 67 largest corporate clients who paid more than \$1,500 in fees accounted for 92 percent of total revenue, or \$635,300. The 82 largest corporate clients who paid more than \$1,000 in fees accounted for 95.42 percent of total revenue, or \$654,000. *In other words, their 100 smallest corporate clients accounted for less than \$32,000 in total revenue (less than 5 percent of total corporate revenue.)*

Their firm is typical of many firms I work with.

What does all this mean?

If your firm is like theirs, it means you can raise your minimum annual fees for corporate clients to \$1,000. If you lose *all* clients who pay less than \$1,000, you won't even notice

the revenue loss. Plus, with more time to spend with remaining clients, you can probably enjoy an increase in other more valuable services such as estate planning, financial planning, and business advice.

Note that you may not *lose* money directly on serving smaller clients, but there are several reasons why you should consider terminating them:

- Most likely, these clients demand a large amount of routine compliance work which is low profit and which *distracts the firm from seeking opportunities for more profitable value-added services (VAS)* for its better (usually larger) clients.
- The work these clients demand is often boring, leading to low morale among your employees.
- These clients require a higher percentage of owner time than larger clients and make it harder to leverage the owners.

Your market position should be, “Yes, we are expensive, and our clients think we are well worth it because we do more than just compliance work.” You should *never* compete on price. For any prospects who seem extraordinarily interested in low prices, you should respond:

Perhaps you would be happier elsewhere. Our clients view us as an *investment* not an *overhead*.

This exclusivity allows your owners and other key employees to devote more time to deepen the relationships with your best clients.

You may be startled by the results. Another of my clients in Ohio found that the smallest 40 percent of their clients accounted for only 4 percent of their revenues. I encouraged them to increase owner rates 32 percent and employee rates 21 percent. The results were dramatic. How dramatic? The year before I worked with them, the six owners made \$360,000. The next year they made \$600,000.

And it all starts with client evaluation and client pruning.

When looking for people whom you want to help, you will run into all types of people. Because you only have so much time on this earth, it makes sense to spend it with people who will make smart choices about their business and personal finance. It’s smart to walk away from people who probably won’t be good clients.

Based on 20 years’ experience as an adviser to accountants, it is clear that this means, going after the *premium* clients—people who want the best advice and will pay for it. But what about the clients you already have? Have you accumulated some losers? It’s easy to do. I know because I did it, too.

When I first hung out my shingle, I had a strict client selection criteria: A client had to fog a mirror held under his or her nose. And if he or she could pay me, that was even better, but it wasn’t necessary because I had lots of time on my hands and nothing better to do. Another accountant who started from scratch told me his gauge was, “Do they have a checkbook?” Perhaps you used similar standards when you first began practice.

But that was then; this is now.

If you're like most of the accountants who attend my seminars, you have been in practice for a few years and you are now quite busy. Even in the summer months, most seminar participants tell me that it would take them two or more weeks to catch up with their current work even if no more new work came in. In other words, *they have a two-week backlog even at a supposedly slow time of year.*

If that description fits you, then maybe it's time to be a little more selective about who you will accept or retain as a client.

If so, it's time to cull the herd.

KEY POINT: Whether you realize it or not, if you are busy, you are auctioning off a limited amount of your services. Sell them to the highest bidder.

I've met many accountants who were uncomfortable about confronting unsuitable clients. But you show me an area of your practice you're having trouble with, and—11 times out of 10—I'll show you an area you're not confronting.

A number of you reading this book have never shown a client the door. I guess we all hope that problem clients will somehow become easier to handle in the future. Or maybe we think that it's really our fault. Well, that's just not true. If the client is difficult, move on. You are highly skilled at your profession; if things aren't working out, you know it must be their fault.



EVALUATE CLIENTS REALISTICALLY

Often, a large part of client relations problems and other practice problems originate with a small number of clients—clients who may also be the least profitable ones. Also, accountants may find that a high percentage of total write-downs comes from a small number of difficult clients.

As discussed earlier, the best clients realize that your fees are not overhead (which will reduce their profits), but are investments which will enhance their profits, either directly or indirectly.

There are many ways to evaluate your clients. Here are just two:

1. Begin your evaluation by preparing a list of all clients in descending order of fees. Treat related entities as a single client for purpose of this analysis. Many time-keeping systems can generate this report on a year-to-date or last-year basis. If not, your system may be able to generate a spreadsheet-readable file. You can use the spreadsheet program to calculate the realization percentages, average hourly rate, write-downs, and so forth.

Then draw a subtotal at the smallest client included in 80 percent of your revenue. See what your average effective chargeout rate per hour is for those larger clients. Compare it to the rest of your clients. Any client with an average hourly rate of less than the 80 percent of the larger clients is a candidate for culling.

2. Here's another analysis: Since you probably have hundreds of clients, most of whom have write-downs, trim your list to a manageable number. Sort the list in descending order by absolute amount of write-downs. Focus first on clients with write-downs of over \$1,000 and with realization of 10 percent or more below the average for your firm. For example, if your average realization is 90 percent overall, focus first on those clients with *both* write-downs exceeding \$1,000 per year *and* realization of less than 80 percent.

This should give you manageable number of clients to work with. Begin by analyzing those clients for corrective action. To oversimplify, let's divide clients into four classes as shown in Exhibit 6-1, "Client Classification Matrix."

1. *Premium Clients*. Certain clients are costly to service but are quite willing to pay a fair price. They go first class and are willing to buy the ticket.
2. *Aggressive Clients*. On the other hand, some clients demand costly services, but don't want to pay for them. They negotiate on prices and get bids from competing firms. These clients are *aggressive*. CPAs are, by nature, risk averse. We tend to avoid conflict at any cost, especially with clients. This manifests itself as a lack of confidence. Clients, on the other hand, often sense this and—because they are used to negotiating every day in their business—use our lack of confidence to beat us up on price.
3. *Economy Clients*. Most accountants also have clients with either limited means or economical tastes who don't ask for much and don't pay much.
4. *Delighted Clients*. And most accountants also have clients who are extremely satisfied with their services and will pay almost any invoice their accountant submits without thinking about it. These *delighted* clients may be small or large; the distinguishing characteristic is their high level of satisfaction and their ability and willingness to pay good prices.

For most CPAs, over 90 percent of their clients are delighted, based on the percentage who return year after year.

I want to stress that *delighted* clients in the low-cost, high-price corner are not sheep; they are very happy and the accountant is a *bold biller* on those clients. The accountant takes appropriate consideration of the clients' high level of satisfaction to charge good prices.

Likewise, I have reviewed the profitability of hundreds of clients that are in the high-cost, low-price quadrant. Most of these clients are not *aggressive*. In fact, the CPA may never have discussed prices with these clients. The reason these clients are not profitable to serve is that the accountant is passive. The accountant simply does not engage the client in a discussion of the account and its lack of profitability. The accountant is a *bashful biller* who *seldom* discusses his or her prices with clients! Many of these accountants discuss prices only if clients broach the subject.

Fortunately, the vast majority of clients love your service and will readily pay more if you approach them right.

But I will begin with the worst ones.



PICK YOUR FIVE WORST CLIENTS AND FIRE THEM OR UPGRADE THEM

How do you usually get rid of clients?

You may occasionally just “bill the client out the door” by sending him or her an invoice so high they can’t stand it. Or, as one CPA put it, “Bill ’em till they bleed!” But then your disgruntled former clients may tell people that you tried to gouge them. Besides, then it is the clients’ decision to leave, not yours. The clients are *cause* and you are *effect*. That’s no good for your ego; if you were the one who ran the clients off, you should get emotional points for courage. Finally, your employees will respect you more if you take the initiative to cull unsatisfactory clients.

You can also just send the clients a termination letter without explanation. Then the clients feel betrayed and abandoned. Again, you have unhappy former clients who are likely to tell others how they feel.

There is no point in making unnecessary enemies.

Let me tell you about a low-risk way to either upgrade these clients or else get them to leave your firm, but on good terms. I call it *Cottle’s Apple Pie*. Like a recipe, you must follow it exactly if you want to get the best results. Don’t get creative until you’ve baked the pie at least five or six times; then you can experiment.

If you change any part of my recipe, your results will be different. Maybe better, maybe worse, but certainly different. If you try just part of the recipe and don’t get good results, don’t blame me. It won’t be Cottle’s Apple Pie; it will be yours.

The idea is to take your clients in the aggressive quadrant of the client classification matrix, and move them over to premium by increasing their prices, or down to economy by reducing your costs.

Using this method, one South Carolina client upgraded 24 out of 24 bookkeeping clients from unprofitable to profitable. Another accountant in Britain used this with 13 clients, and upgraded 12 and terminated one. I can practically guarantee you that your profits on the affected clients as a group will be larger after you do this process than they were before.

But you have to follow the script the way I’ve written it. Got that?

1. *Pick five small clients you are better off without.* These should be small enough so that you would not miss their revenues if they were gone. Don’t do this with major clients, no matter how unprofitable they have been; the risks are too great. Start with small clients, get really good at handling them, and then move gradually up to the larger clients. Think of these five small clients as

exhibition games. Practice on them, then you will handle the larger clients easily. The clients you choose should have been subject to large write-downs in the past, perhaps slow pay, maybe even with records in lousy shape.

If you have 100 or more clients and have not previously gone through client culling, it's a good bet you have at least five clients that fit that profile. You know the ones I mean; you probably have three of their names on the tip of your tongue. If you need to, prepare client evaluation forms to help you select your five. See Exhibit 6-2, "Sample General Client Evaluation Form;" Exhibit 6-3, "Sample Corporate Client Evaluation Form;" and Exhibit 6-4, "Sample Tax Client Evaluation Form."

2. *Mentally fire the clients.* Make the emotional decision that these five people are no longer clients. They are *history*; they just don't know it yet. This frees you of a mental burden because now, you don't have to decide whether to fire them. You can now decide whether to accept them as a new client in a new unit of time.
3. *Set up an appointment at the first client's office.* Call the client and say, "Charlie, there's an important matter I need to discuss with you. Can we get together at your office?" Charlie Client may want to know what the meeting is about. If so, say:

I've been thinking about our relationship. There are a few things I am concerned with and it occurred to me that you might be a bit concerned about our relationship also. I'd like to come see you. Can we get together at your office?"

Let's presume you have a real hard case who says:

Client: Well I don't want to see you, because every time I talk to you I have to pay for it.

Accountant: This meeting is on me, Charlie. There are some things we need to talk about. Can we get together at your office?

Client: Why can't we talk about it on the phone?

Accountant: I don't think our relationship is very good. I have some things that we need to discuss in person. Can we get together at your office?"

Note that you *end every scripted response with a question.* The one who asks the questions controls the conversation.

4. *At the meeting, review with the client your time-keeping and invoicing records for the last few years.* This may be the first time Charlie has had a chance to see his fees from your viewpoint:

Charlie, this year your engagement cost us \$9,000 and we charged you only \$7,000. Still, you complained and took 90 days to pay us. The year before, your job cost us \$7,950 and we charged you \$6,500 and you said we were too high. The year before that, you cost us \$6,000 and we only charged you \$5,000.”

Think about it: Most clients only see your invoice; they never see your time records and they have no idea whether you made money or lost money on their work. Remember the *iceberg of time*? Most of them think you make far more money than you actually do. Give your (former) client a chance to “walk a mile in your moccasins.”

5. *Pause and give the client a chance to comment.* If you’re lucky, the client may say something like:

Gee, I didn’t know that. I guess that means you’re going to raise my fees a lot next year.

Don’t laugh; it has happened. Bravo! You now have a premium client.

At least give the client a chance to respond. You may then discuss how much time it takes, how to reduce your costs, what services to eliminate, how to improve the client’s cooperation to reduce your costs, and so forth. That can move them to economy.

If that conversation does not produce a good result, or if the client says nothing, go on to the next step.

6. Say, “*If you were me and you had a client like this, what would you do?*” Then shut up, and wait for the client to respond. This is not a rhetorical question; you really want an answer. It may take 10 or even 15 seconds for the client to respond, but wait it out.

Note that you have not told Charlie that he has been terminated. You have not burned any bridges, and you have not made the client wrong. You have merely given him some additional data about your relationship which he never knew and asked him his opinion. And you have encouraged him to look at the situation from an exterior, impersonal viewpoint by saying “a client like this” not “a client like you.”

Clients who are really good negotiators may take so long to answer that you will wonder whether they will ever speak. What’s actually happened is that these clients realize that they’ve been caught. They got Cadillac service all these years for a Volkswagen price and they are feverishly trying to figure out what to say that will distract you so you will keep serving them for the same price. Eventually, they will respond.

At this point the client has a number of options, as described in the following sections.

Client: “*Why tell me this now? I don’t understand; you never had a problem with what I pay in the past. Why now?*”

This is the most embarrassing response of all. In effect, the client said, "What woke you up?" For many accountants, that's not the case at all.

So just say:

It's only recently that we have become aware of this situation. In the past we have focused exclusively on giving you the best possible service. Frankly, we haven't paid much attention to what it cost to serve you. Recently, we made a detailed analysis of all our clients and discovered that you paid far less than our other clients.

Not only does this script work, it has the additional virtue of being true. Until you read this book and did the analysis, you probably had not focused on just how unprofitable some of your clients are. If you had, you might have done something about it sooner. Faced with assertion, the client may just submit to the inevitable, and say, "I guess this means I have to pay more next year."

In which case you agree, and you retain the client, who is now profitable for you to serve. Bravo! Say something like this:

That's right. And because of our friendship, I felt I needed to personally explain the situation to you. I didn't just want to send you a much larger invoice next year without explanation.

Congratulations! You now have accepted a new premium client who will be profitable to serve.

Client: "You are inefficient and you should be able to do the work for less."

If your client is a tough negotiator, he or she may say something like this. Every business owner in the world wants to get what they buy for the best price. Heck, every *person*, whether they own a business or not, looks for bargains. That's their job. As business owners and even as savvy consumers, some clients will always object to your prices. That's what they do.

Of course you're not inefficient. Even if you were, the client has no way to know. It's just another negotiating ploy. Don't take this comment personally; take it professionally. This sort of approach is typical of an aggressive client. They don't mean it; it's just a smoke screen.

Don't get into a discussion of how efficient you are; you can't win. Instead, say:

Actually, we've been your accountant for four years now, and that's how long it really takes.

Here is where your mental termination decision keeps you from caving in. You looked the client in the eye and—in a friendly but firm manner—you told him or her confidently that you have performed the job in a proper manner and that is what it costs.

And you might add:

I have to make a living.

Then repeat the question, "If you were me and you had a client like this, what would you do?" Again, *shut up*, and make the client respond.

Client: *“But that isn’t really your cost; that standard fee includes a profit”*

This aggressive response is a brazen, yet clever, attempt to exploit some accountants’ guilt at the fact that they must actually make a profit or go out of business. Some accountants subconsciously downplay the fact that they make a good living (or at least try to).

Again, your response must be firm, confident, and unapologetic:

Don’t I deserve to make a living?

That might generate a discussion on the ethics of capitalism or some such philosophical talk, but, most likely, the client will agree that you do, in fact, deserve to make a profit.

Whether or not they agree you deserve to make a profit, continue:

Charlie, if you take my profit, I can’t stay in business to help you in the future. I have to make a profit just like you do. So the real question is, “If you were me and you had a client like this, what would you do?”

Do you see the trend here? You keep coming back to, “What would you do?” You are friendly, calm, patient, and persistent, very persistent.

Client: *“But you don’t really expect to get 100 percent of standard”*

That may be true, so you can also say:

Yes, and I get an average of ___ percent on all my other clients. So, the question is, “If you were me and you had a client like this, what would you do?”

Again, remain silent for the client to respond.

Client: *“Your people falsify their time sheets; it doesn’t take that long”*

An extremely small number of aggressives are so bodacious that they actually try this one. Don’t get into an argument about your ethics or the honesty of your employees; the client doesn’t really mean this. It’s just another negotiating tactic. Don’t argue and defend your people. Just continue the conversation on your terms:

Charlie, I know you don’t really mean that, because you would not want an accounting firm whose people you didn’t trust. It really does take that long. So, the real question is, “If you were me and you had a client like this, what would you do?”

Client: *“I promise to work with you to reduce your costs to do my work”*

Sometimes a sloppy client will reform, but don’t hold your breath. You have a better chance if the client has a bookkeeper you can train. Naturally, you charge for training time. At least give him or her a chance. But make sure the client knows you will charge exactly what it costs at standard next time.

Client: *“Please, please, pleeease! (Sniff.) Keep doing my work at a loss”*

Some clients will simply beg for mercy. They will roll over, play dead, and hope you will take pity on them. "I just can't afford to pay any more!" or some such. If that is truly the case, you need to refer them to an economy firm. Most likely, it's just another negotiating tool:

Charlie, doing your work at a loss is not an option. I have to make a living just like you do. You can't continue to do business with customers you lose money on, and neither can I. So, the real question is, "If you were me and you had a client like this, what would you do?"

By this time, if the client has not agreed to pay more or work with you to reduce your costs, they are left with the final option.

Client: "If I had a client like this, I would quit doing the work"

You have given the client several opportunities and hints to allow them to bring up the subject of reducing your costs or paying more. Your ideal scene is to make them a premium client. Your fallback position is to make them an economy client. At this point, they have not volunteered to do either. Make a last ditch try to convert them to economy by saying:

Charlie, I guess you're right. We always hate to lose a client, especially one who is a friend like you. But if we cannot either increase our price or figure a way to reduce our costs, that's what we'll have to do. [*Pause again to see whether they want to take either option.*] Because of our friendship, I wanted to discuss this situation with you personally. It is a business decision and not a personal one. Even though we won't be able to do business with you anymore, I want us to remain friends.

In any event, you part on good terms.

Most of my clients who do follow my Cottle's Apple Pie recipe exactly report that more than two-thirds of such clients remain at substantially increased prices.

Handle the next four clients the same way. You'll be glad you did.

By the time you finish five clients, you might be surprised to learn just how valuable clients think you are and how much they will pay to access your expertise. Your self-confidence will soar.



FIRE THE LEAST PROFITABLE CLIENTS

If you had time available to talk to clients, and the team members available to do the work, how much VAS could you sell your current clients?

Imagine I could wave a magic wand and clone you, clone your fellow owners, and clone your employees. Your firm now has twice as many people and the same number of clients. In this imaginary world, you are no longer busy; you are no longer two weeks behind. In fact, you are actually looking for more work.

Now you have time to follow up with all those clients who want to talk to you about their investments, their retirement plans, their strategic planning, their exit strategies, their

estate situation. You have the time to talk to them and—just as important—you have the people available to do the extra VAS work.

How much of this extra VAS work could you sell? 20 percent? 50 percent? 70 percent? Many participants report they can sell between 20 and 70 percent more work to their current clients if they had the time to talk to them and the people to do the work.

Would this new work be at higher rates than your current average? Lower rates? The same rate? My participants uniformly report that the new work would be at significantly higher rates, usually 25 to 50 percent higher than their current average.

Let's see what effect this could have on your profits.

Example: Suppose you charge 1,500 hours a year at \$175 an hour, net right now, yielding \$262,500. Even though the *average* rate is \$175 per hour, not all of those hours are of equal value; that's why you have write-downs. Let's suppose the worst 10 percent of your hours is only worth \$70 per hour, about what you would charge for a staff accountant.

If you terminate those 150 hours, you lose \$10,500 of revenue.

If you then resell those hours at just 20 percent more than your current average rate, you generate 150 hours times \$210 per hour, or \$31,500 of revenue.

You gain \$21,000 with no increase in costs. It all comes down to the bottom line.

KEY POINT: So, fire 10 percent of your clients... and resell those hours at a higher rate.



INCREASE YOUR MINIMUM INDIVIDUAL INCOME TAX PRICE

Sort your individual clients from highest price to lowest price. Draw a line where the sales above the line account for 80 percent of your total individual tax revenue. If you do returns for minor children or other relatives, treat all members of the same family as one client. Set your minimum price for clients for whom you perform no other work at that amount. For many firms, that figure is about \$400 to \$500.

Immediately institute that number as your minimum price for all new clients.

And I would look carefully at current clients whom you charge much less than that to see whether you should encourage them to go to another accounting firm or to purchase additional services from you—such as a year-end tax planning conference, estate planning, or investment advisory services—to get them above the minimum..

Example: A small firm had 310 individual clients, which accounted for \$171,000 of revenue, averaging \$550 per client. The 134 individual clients who paid more than \$400 accounted for \$134,000 of revenue (78 percent of the total 1040 revenue), averaging \$1,000. *In other words, their 176 smallest individual clients accounted for less than \$37,000 in revenue* (in their case less than 5 percent of total revenue), averaging \$210.

If your firm is like theirs, you could raise your minimum annual price for individual clients to \$400. If you lost *all* clients who pay less than \$400, you would prepare less than half as many returns and the revenue loss would be immaterial. Plus, with more time to spend with remaining clients, you could probably enjoy an increase in other more valuable services such as estate and financial planning.



RAISE PRICES ON AGGRAVATING CLIENTS TO \$200 ABOVE STANDARD

Life is too short to work with people that cause turmoil in your life or your practice. If you have clients that are a pain in the neck, next year charge them \$200 above standard. If they are a pain in the neck, at least make them pay for the privilege.

If they don't come back, you don't care. If they come back, consider raising them to \$300 over standard.



GIVE YOUR "WIDOWS AND ORPHANS" TO ANOTHER ACCOUNTANT

If you are like most accountants, you have accumulated your share of "widows and orphans" over the years. You probably took these on when you just started practice and were glad to get anything that you could to keep busy. But your firm is bigger now and these clients are still hanging around. These small clients might be good clients for a new accountant just starting practice.

Chris Frederiksen, a California CPA, suggests a good way to get rid of these small clients without throwing them out into the cold: Call a local practitioner who might want to take these clients on and arrange to introduce these clients to him or her. Then, send a letter to your small clients notifying them of your new minimum prices and suggesting, "We have made arrangements with another accountant who will serve your needs for prices close to what you have been paying. Do you want us to arrange an introduction?"

Then, as Chris says, you have two people who love you—the old client and their new accountant.

EXHIBIT 6-1: CLIENT CLASSIFICATION MATRIX

Cost to service	High	Aggressive (CPA is passive) bashful biller	Premium
	Low	Economy	(CPA is bold biller) Delighted
		Low	High
		Prices	

EXHIBIT 6-2: SAMPLE GENERAL CLIENT EVALUATION FORM¹

Client Evaluation

Client: _____

Evaluator: _____

Date: _____

	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>	<i>Total</i>
Value of services to the client			X			3
Development potential	X					1
Client cooperation			X			3
Economic stability			X			3
Timeliness of payment			X			3
Rating						13

- 1 = Excellent
- 2 = Very Good
- 3 = Average
- 4 = Fair
- 5 = Poor

¹ "Client Engagements," Chapter 204 of the *Management of an Accounting Practice Handbook*. New York: American Institute of Certified Public Accountants, 1996, Exhibit 204-19, page 56.

EXHIBIT 6-3: SAMPLE CORPORATE CLIENT EVALUATION FORM²

Client: _____

Account Manager/Partner in Charge: _____

Evaluation by: _____

Date: _____

(Circle only one number in each group.)

What is the usual condition of records?

- 2 Unusable or always late
- 4 Scattered but workable
- 6 Client needs orientation
- 8 Good
- 10 Excellent

What is the reaction to our prices?

- 1 Prices always challenged as too high
- 5 Requires itemized invoice
- 10 Usually accepts amount of invoice
- 15 Wants service and expects to pay
- 20 Thinks we are superior—pays premium

What is the potential for growth?

- 5 Terminating
- 10 Decreasing
- 15 Level
- 20 Growing
- 25 Unlimited

What is the total annual fee?

- 3 To \$2,500
- 6 \$2,500–\$7,500
- 9 \$7,500–\$15,000
- 12 Above \$15,000

What is the attitude toward the IRS?

- 1 Apprehensive
- 2 Hostile
- 5 Apathetic
- 8 Cooperative

What is the attitude toward referrals?

- 1 Would never do so
- 2 Might do so
- 12 Has not in last year
- 16 Referred in last year
- 20 More than once in last year

What work is done for client?

- 3 Bookkeeping
- 6 Reviews or compilations
- 9 Audits
- 12 Year-end work and special services
- 15 Comprehensive VAS

What is the client's dependence on us?

- 1 Minimum service
- 2 Security regarding IRS
- 3 Counseling
- 4 Timely service
- 5 Direction and tax planning

What is the payment history?

- 1 May never pay
- 2 Always 60 days late
- 5 Pays within 30 days
- 10 Pays within ten days

From whom does client seek information?

- 1 Client's employees
- 2 News media
- 3 Client's competitors
- 4 Client's friends
- 5 Professionals (including us)

²*Ibid*, Exhibit 204-20, pages 57-58.

What is the attitude toward expenses?

- 1 Spendthrift
- 2 Stingy
- 3 Economical
- 4 Liberal
- 5 Goes "first class"

Does this client exposes the firm to legal action?

- 1 High risk
- 2 Would consider suit
- 3 Low risk
- 4 Little risk
- 5 Would hesitate to sue

What is the attitude toward our employees?

- 1 Critical and argumentative
- 2 Uncooperative
- 3 Usually cooperative
- 4 Businesslike
- 5 Friendly and appreciative

What is the client's financial strength?

- 1 Insolvent
- 4 Solvent but undercapitalized
- 8 Adequate
- 10 Strong capital structure

Above conditions prevailed at month of

Scoring:

Maximum = 154 points

Minimum = 23 points

30 points and below = Drop client

30 to 50 points = Evaluate in 90 days (on trial)

50 to 70 points = Make an attempt to upgrade client

70 points and above = Retain client

Total points

Make additional comments below:

EXHIBIT 6-4: SAMPLE TAX CLIENT EVALUATION FORM³

Client: _____

Account Manager/Partner in Charge: _____

Evaluation by: _____

Date: _____

(Circle only one number in each group.)

<i>Criteria and Relative Weight</i>	<i>Points</i>	<i>Description</i>
1. Prestige (5 weight)	25	Community or business leader
	20	Attorney/banker
	15	Teacher—professional school
	10	Civic organization/other
	5	Friend
	0	Relative
2. Referrals—actual (6 weight)	30	Frequent and valuable
	24	Few and valuable
	18	Few and marginal
	12	None
	6	Few and worthless
	0	Frequent and worthless
3. Referrals—potential (1 weight)	5	Frequent and valuable
	4	Few and valuable
	3	Few and marginal
	2	None
	1	Few and worthless
	0	Frequent and worthless
4. Tie-in (2 weight)	10	Close relations to key clients
	8	Close relations to many clients
	6	Close relations to some clients
	4	Close relations to few clients
	2	Close relations to no clients
	0	Could cost us clients
5. Fee range (9 weight)	45	Over \$15,000
	36	\$5,000–\$15,000
	27	\$2,500–\$5,000
	18	\$1,000–\$2,500
	9	\$500–\$1,000
	0	Less than \$500
6. Billing as a percent of standard rates (8 weight)	40	100 Percent or more
	32	95–100 percent
	24	90–95 percent
	16	80–90 percent
	8	75–80 percent
	0	Less than 75 percent

³*Ibid*, Exhibit 204-21, pages 59-60.

<i>Criteria and Relative Weight</i>	<i>Points</i>	<i>Description</i>	
		<i>Individuals</i>	<i>Corporations</i>
7. Cooperation—when does information come in (4 weight)	20	Before February 1	1/15
	16	Before March 1	1/31
	12	Before March 15	2/15
	8	Before March 31	2/28
	4	Before April 15	3/15
	0	After April 15	3/15
8. Information quality (3 weight)	15	All at once; neatly arranged	
	12	All at once; messy	
	9	Up to one-week delay for additional data	
	6	Up to two-week delay for additional data	
	3	More than two-week delay for additional data	
0	Inadequate documentation		
9. How long to pay invoice? (7 weight)	35	by return mail	
	28	15 days or less	
	21	30 days or less	
	14	45 days or less	
	7	60 days or less	
0	More than 60 days		
10. Value of services to client (10 weight)	50	Services only we can perform	
	40	Services others can perform but we can do better	
	30	Service other professionals can perform	
	20	Services “anyone” can perform	
	10	Services others can perform cheaply, faster, or better	
0	Services we are not competent to perform		

Scoring:

- Maximum score = 275
- Minimum score = 0
- 275-240 = Excellent
- 239-200 = Very good
- 199-150 = Good (attempt to upgrade)
- 149-80 = Fair (evaluate in 90 days)
- 79-0 = Poor (drop client)

Total points

Make additional comments below:

CHAPTER 7

SEVEN CAUSES OF UNPLANNED WRITE-DOWNS AND HOW TO AVOID THEM

America's national pastime isn't baseball; it's *watching the boss*. Or, in the case of accounting firms, the owners.

Owners represent success to the employees. So employees study the owners' actions and emulate them. Whether the owners know it or not, they serve as examples for the employees to follow. The habits of the owners, whether good or bad, pervade the firm.

- If the owners conscientiously get their own time reports in on time, the employees will, too.
- If the owners do their invoicing promptly, the employees will, too.
- If the owners are confident in their dealings with clients, the employees will be, too.

And *vice versa*. Many of the writedowns that accounting firms suffer stem, directly or indirectly, from the top. As you read this chapter, ask yourself, What kind of message do I send the other people in the firm by my words and actions?

Most unplanned write-downs result from one or a combination of only a few factors. This chapter defines write-downs and discusses the seven causes behind them.



WHAT ARE WRITE-DOWNS, REALLY?

Write-downs are different from every other cost in one respect: They are a synthetic expense, because they are not a necessary cost of doing business like rent or salaries. You could completely eliminate write-downs by reducing standard chargeout rates to zero; then all invoicing would result in write-ups.

Revenue results from *production* (doing the work) and *pricing* (charging the proper amount). And net income is revenues, minus the costs of earning those revenues (*cost management*).

Accountants' opinions differ about whether write-downs are a function of pricing or cost management. Sometimes an accountant accepts an engagement knowing he or she will not recover standard fees. Such write-downs are expected and planned in advance and are clearly a *pricing* decision.

Example: McFrugal & Cheep agrees to perform a professional service during its off-season for 70 percent of its normal rates.

Other write-downs are unplanned and may reveal poor cost management.

Example: Speck & Calculus estimates an engagement will cost \$11,500 at standard chargeout rates. It agrees to do the assignment for \$11,500. While performing the job, unexpected difficulties increase the standard charges to \$13,000. Speck & Calculus takes a write-down of \$1,500.

In either case, a write-down is the difference between what the client would have paid if you invoiced your standard charges and what he or she actually does pay.



CAUSE 1: ESTIMATING THE ENGAGEMENT INCORRECTLY (MISCALCULATING THE COST TO DO THE JOB)

If you've ever visited a good restaurant on a Saturday night at 8:00 P.M., you may have been told there is a 45-minute wait. Yet, if you looked at your watch, you may have noticed that you were actually seated in less than 45 minutes. The reason: Better restaurants have learned to give the customer a better experience by conservatively estimating customer wait time. In other words, they lower the customers' expectations, so the restaurant can more easily beat its own estimated wait time.

We accountants should learn from their example.

If your construction clients estimated jobs they way most accountants do, they would all go broke.

The typical owner sends Sarah Supervisor to estimate a job because she has lots of experience with this client or this type of job. She comes back with an estimate of, say, \$12,650. "Sorry, Sarah," the owner says, "That's the wrong number. To keep this client happy, the correct number is \$10,000. Go back and try again."

So Sarah looks at her figures and thinks, "Maybe this year we won't have the inventory cut-off problems we've had on this client every year for the last three years. And maybe we won't have the overhead allocation problems we've had for the last three years. And maybe we won't have..." So she takes out all the margins for client errors that the firm has needed in the past. She returns with the \$10,000 budget but warns, "Boss, if we so much as have a power surge in the field and have to stop to reboot our computers, we can't make this budget."

KEY POINT: *Murphy's Law*—If anything can go wrong, it will.

The owner blissfully ignores *Murphy's Law*, puts on rose-colored glasses, and accepts the estimate, *which he or she duly conveys to the client*. This creates the client's false expectations. If optimism was measured on a scale of 1 to 10, the owner has chosen to be a 12. Yet even as the words come out of his or her mouth, the owner knows that making that budget is about as likely as Greenland becoming the next popular beach resort.

KEY POINT: The owner knows the firm will not make the optimistic budget, the supervisor knows it, but *the client doesn't know it* because the firm has misled them!

I can understand using a best-case, rose-colored glasses, optimistic budget to control the job and give the employees something to shoot for. But if you give the client that same figure, it is like the restaurant host thinking, “If no one orders dessert, if no one has an extra cup of coffee, and if everyone pays cash, with correct change, then we can seat this customer in 25 minutes.” It ain’t gonna happen.

KEY POINT: *Murphy’s Second Law*—Everything takes longer than you think. Build a 20-percent pessimism quotient into all engagements.

If the client’s cutoff procedures for purchases, or shipping, or invoicing, or anything else have been lousy for the last several years, what makes you think they will be any better this year?

Yet, we kid ourselves and budget the job assuming everything will work well. As I said, optimistic budgets are okay to give employees something to shoot for. The problem arises if you use the optimistic budget to estimate the price for the client—*or for ourselves!*

Key Point: And if you quote a price range, quote only the upper end of the range. If you quote the low end, the client will only remember the low end.

Even if you accept Sarah Supervisor’s first estimate and later analyze the actual time objectively to improve your estimating process, you learn nothing unless the data are accurate. Unfortunately, some accountants go through a rigorous process to prepare a time budget, and then neglect to post the actual time spent on the various components. Thus, they cannot compare actual to budget.

Exhibit 7-1, “Sample Client Time Budget,” is a form for budgeting time.

The time budget does little good unless you compare it with actual. Many accountants fail to keep systematic records to track the results of their budget processes. The only number they know for sure is the *total hours* spent by each person. But those data are available from the time-keeping system and do not enable the accountant to evaluate the performance of the ones who worked on the engagement. You should treat each line item on the time budget as a contract between the firm and the personnel who are to perform that part of the engagement. If they go over budget, you should hold them accountable. *But you have to know the actual time spent on each section.*

Exhibit 7-2, “Sample Cost-Effective Service/Work Codes,” illustrates one way to use cost-effective service codes for client cost accounting and invoicing. You can use the same codes to design a form for accumulating actual time if you don’t do it on computer.

Consider the typical problems you run into:

- The bank accounts are not reconciled.
- The receivables are out of balance.
- There is no general ledger.
- The account codes are inconsistent or just wrong.

- The transaction volume is much higher than you thought.
- There was large turnover in the accounting department.

When do you learn about these things? Before you begin the work or after?

The time to handle difficult matters is before they become difficult. Is there ever a time when these types of problems are easy? Yes. *When you first learn of them.*

We've all heard the horror stories of huge write-downs from apparently inescapable circumstances that led to the disaster.

But think back: Was that fiasco really necessary? Was there anything the accountant could have done earlier in the engagement that might have avoided, or at least reduced, the write-down?

The answer is usually, "Of course, if I had just had time to do the budget... or review the condition of the records... or look at the volume of transactions... or... or... or...."

We all have the same 24 hours each day, so, "If I had just had the time," actually means, "If I had just *taken* the time."

The correction actions that would have prevented disaster always could have and should have been taken earlier in the engagement, before things got out of hand.

KEY POINT: An ounce of planning is worth a pound of performance (to paraphrase Ben Franklin).

And I might add:

KEY POINT: An ounce of communication ahead of time is worth a pound of finger-pointing after the fact.

I learned a hard lesson from my own practice back in the 1970s: It's better to learn the client has a severe cash-flow problem *before* you run up \$10,000 of work-in-progress (WIP) on the audit. And 30 years ago, \$10,000 was a lot of money.

KEY POINT: The best time to discover problems is when your leverage is better than the client's. That is before you start work. After the firm's time has been expended (and is, of course, 100-percent perishable), the client has the upper hand.

You want to find out about the problems while the client is still hurting and needs what you have to offer. After the engagement is complete, after the client's problem has been solved, you may have to come and beg for your money.

The key issue is, *When do the people who must resolve the problem first learn about it?*

For example, one of my client CPA firms had audited a nonprofit organization for the last three years. Fees ran \$2,500 to \$2,950 each year. The firm quoted a price for the fourth year of \$2,950. The client was not as well prepared as in the past and the in-charge did substantial work to get the records in shape to audit. Standard fees ran over \$4,000.

Naturally, the firm lost money. The owner in charge of this small job was not aware of the overrun until he reviewed the file in the office—after the horse was out of the barn!

The in-charge quickly learned of the problem when he was in the field, but he never told the owner.

The ideal is that the supervisor becomes aware of problems very quickly after the staff person does, and the owner should learn of the problem soon after that.

If the client only learns of the problem weeks later, perhaps because the invoice is larger than he expected, serious trouble will be created in client relations.



CAUSE 2: NOT SPECIFYING CLEARLY WHAT IS INCLUDED IN THE PRICE ESTIMATE AND WHAT IS NOT

Accountants often quote a client a retainer or fixed price for an engagement. If they do not specify clearly what the engagement includes and—more important—does *not* include, they can get sucked in to doing more and more work each month without charging for the extras.

This is the “scope creep” mentioned earlier.

One way to avoid this unpleasant situation is to hold two planning conferences: One with the client and one with the staff who will work the engagement.

Client Planning Conference

The *client* planning conference has several objectives:

- Set clear boundaries to the engagement.
- Control the client’s expectations.
- Ensure the client’s commitment to provide assistance to keep your costs down.
- Ensure the client’s willingness to pay your invoice.
- Ensure that extra work will be charged to the client.

The client planning conference ensures that clients understand:

- What work that your firm will do, which is contemplated in the price estimate or time budget
- What work is specifically excluded, or will be charged extra (with special emphasis on items you did last time that you now want the client to do, or items included in the price last time that are not included now)
- What the client’s employees’ responsibilities are for the successful completion of the engagement (Include schedules to be prepared by clients, documentation to be gathered by them, and so forth.)

- How you will determine the price
- When the client will pay

Exhibit 7-3, “Sample Client Planning Conference Form,” is a form to document the planning conference with the client.

Staff Planning Conference

The objective of your staff planning conference is to avoid scope creep. How? The conference ensures that firm employees do *only* work covered by the price estimate, and that the client authorizes, and pays for any extra work your employees undertake. The planning conference ensures that employees understand:

- What work the price estimate or time budget covers
- What work is specifically excluded, or will be charged extra (This helps avoid scope creep by putting your team on notice.)
- What each employee’s responsibilities are for the successful completion of the engagement (and that *specifically* includes the responsibilities of the client’s employees)
- How you will determine the price

Exhibit 7-4, “Sample Staff Planning Conference Form,” is a form to document the employee planning conference.



CAUSE 3: INEFFICIENCY (SOMETIMES LAID AT THE FEET OF THE EMPLOYEE’S SUPERVISOR)

Time is an investment. If you or your team work on a client’s account, you invest time. From this activity, clients require a return and so also does the firm.

Consider this: Every hour a person works has a cost to the firm regardless of whether the person is an owner or an employee, regardless of whether the time is chargeable or non-chargeable. You might think of work time (whether chargeable or nonchargeable) as *investment time*. Your people either invest it on behalf of a client (chargeable time) or on behalf of the firm.

Here are a few ways to get more efficient:

- *Repeal Parkinson’s Law*. One reason employees spend so much time on engagements is Parkinson’s Law, which states:

Work expands to fill the time available for its completion.

If you give an employee an assignment without a time budget, they now have a new career. You must give the employee a time budget on every assignment—then, hold them accountable for meeting it.

- *Work in the field whenever possible.* Many smaller clients have no room on their premises for you or your employees to work. Yet, even in a small CPA firm, 20 to 25 percent of the work that you and your employees do could be done in the field. In the field, you work more efficiently because you work straight through without interruption. For instance, if an employee needs information, he or she will find it easily in the field. In the office, the employee often leaves a message for the client and puts the file away to work on another engagement. This *put-away time* and *start-up time* drains efficiency.
- *Stay in the field longer.* **Fieldwork** pays off for both owners and employees. Do as much of your file review in the field as possible. It makes the iceberg of time more visible to the client and creates opportunities for more client interaction—always a good thing.
- *Exclude owner time from the budget.* Your employees cannot control owner time. Putting it on the budget merely distracts them.
- *Do the job backwards.* Draft the financial statements first. Then, see what work you have to do to support those assertions. Often, you will find that if you had simply “worked your way down the balance sheet,” you would have avoided wasting valuable time on immaterial or insignificant items.
- *Post time backwards.* Have you ever noticed how extremely efficient you are the day before you leave on vacation? You know that you must finish everything that day, and somehow you magically get it all done. This is the *Friday-before-vacation* phenomenon. You can put this phenomenon to work in your favor by showing an “hours-remaining-in-budget” balance. The in-charge sees a decreasing amount of time and the Friday-before-vacation phenomenon takes over; everything gets done more efficiently.
- *Post time to the time budget daily.* Have your in-charge accountant post each person’s time daily and compare it to budget.
- *Go to the field to do your review.* Every week, go on a larger job.
- *Make sure your employees have a “chargeable extra” work code under audits, reviews, compilation, taxes, and any other categories of work.* One reason you do not invoice certain chargeable extras is that you do not find out about them because the employees have no place to post the time. See Exhibit 7-2 for sample cost-effective service codes, and note code 090, “Chargeable Extras.”
- *Pay employees at least partially based on how well they meet budget.* Allocate unplanned write-downs on jobs to everyone who works the job, based on how well they met their budgets for the segments they worked on.

Follow several of the above suggestions and you should find the work proceeds more efficiently.



CAUSE 4: BAD SCHEDULING

Bad scheduling can take two forms—assigning an inappropriate person for the job and wall-to-wall scheduling.

Assign the Right Person to the Job

Assigning an overqualified person to work below his or her capabilities is clearly bad scheduling. This uses high-priced talent to do low-value work and incurs unneeded costs. But assigning an underqualified person can also be bad scheduling. People who are in over their heads will often spin their wheels, waste time, and consult with superiors far more often than more qualified staff would.

Peter Drucker points out that people who get little done often work a great deal harder. There are three main reasons for this:

1. *They underestimate the time required for any task.* They ignore Murphy's Law and assume everything will go just right. Yet nothing ever goes exactly right. The unexpected always happens. Indeed, the unexpected is the only thing you can confidently expect. Therefore, allow a fair margin of time beyond what you think you will need.
2. *They try to hurry and that puts them further behind.* Remember the old saying: "The hurrieder I go; the behinder I get."
3. *They try to do several things at once.* They never have the minimum time block needed for any of the tasks on their agenda. If any task runs into trouble, the entire agenda collapses.

Avoid Wall-to-Wall Scheduling

This principle of scheduling a large enough block of time to complete a task also applies when scheduling assistants, particularly in-charge accountants. Too often, an owner will estimate 10 more days of fieldwork for job *Alpha* and thus will schedule the in-charge to begin job *Bravo* in 11 days. This does not allow the in-charge time to wrap up job *Alpha* back in the office. As a result, job *Alpha* languishes on the in-charge's desk, 90 percent complete. Set priorities *with* your employee, because he or she may have information that you do not have.

Don't schedule yourself (or anyone else) wall-to-wall.

Note that wall-to-wall scheduling can be a cause of client price resistance because of the delay that often occurs between the end of fieldwork and the delivery of the finished product. The client sees that your employees "finished" because they are no longer in the field. So, the client expects the finished product in a few days. If it does not arrive, the client is disappointed or jumps to the conclusion that you are inefficient.

Moreover, wall-to-wall scheduling can actually be one cause of this kind of delay. Most assignments cannot be completed in the field. Employees need to review, write the report, and research. Booking them on their next assignment before they have time to complete the last one has several bad effects:

- You have incurred up to 90 percent of your costs but have nothing to show the client.
- Your working capital is tied up in a job many owners hesitate to invoice. (Yet another reason to do interim invoices.)
- The client must wait for the benefit they expected.
- Your employees feel hassled and pressured.
- The work gets “cold” and when employees finally return to finish, they must spend time reacquainting themselves with the details.
- If it is necessary to ask the client questions from the review, the firm looks bad because of the delay.

The cure: Stay in the field as long as possible; do as much work in the field you can; and allow employees an appropriate amount of office time at the completion of fieldwork to finish the job.



CAUSE 5: BAD SUPERVISION

Too often, accountants hide bad supervision by blaming their employees (“That employee should have done that job in 12 hours”) or bad scheduling (“If I had the right person available for that assignment, we could have made budget”). Those circumstances occur, but not as often as we pretend.

Supervision is a complex issue that involves planning, budgeting, and monitoring.

Plan

Owners too often tackle an engagement with no planning. Remember the expression, “Ready ... Fire! ... Aim”? Owners have done so many financial statements, or audits, or consolidated tax returns, or what-have-you, that they view any time spent planning the engagement as wasted. That may be true for small, routine engagements they perform themselves. However, the situation becomes more complicated when they use employees.

Employees do not have their years of experience and may approach an engagement differently.

Example: Imagine you drive from Houston to Austin and back every week. You know which exit to take off I-10, which state highway cuts 45 miles off the journey, and which alternate route across the cities of Houston and Austin usually has the least traffic, depending on the time of day. You do not need to consult a map; you *know* how to do it.

But suppose you decide to delegate that trip to an employee who has never made the drive? You might think, "He or she knows how to drive. If they get in trouble, they can look at a map, or just ask me." The map does not show how much traffic they can expect on each route; only your experience tells you. And an employee may hesitate to ask questions because they do not want to appear ignorant.

You can see how investing five minutes of instruction in the shortcuts can take an hour off the drive. It is no different for professional engagements.

Budget

People can hit a target better if they can see it. The most basic budget is simply to tell the assistant how much time you expect the job to take. Do not expect the employee to look up how much time the tax return, or whatever, took last year. In the first place, last year's circumstances may have been different. In the second place, people do not do what you *expect*, they do what you *inspect*. If the employee thought like an owner all the time, you would pay him or her like an owner. You owe it to your employees and yourself to give them a budget on every assignment.

Monitor

In the 1960s and 1970s, each Apollo moon mission was off course 90 percent of the time. Without "midcourse corrections," they would have missed the moon by more than 10,000 miles. A firm's assignments are similar; they need "midcourse corrections." Giving an employee an 80-hour assignment and then waiting two weeks to check on them is wishful thinking. One of my large audits grew from 200 hours to 1,000 hours over a period of years. I never missed the time budget by more than 2 percent. I visited the field weekly and reviewed the work, conferred with the audit manager, and then met with the client to report on the status and make any needed revisions to the budget and schedule.



CAUSE 6: INADEQUATE SKILL IN MANAGING THE CLIENT RELATIONSHIP

The supervisor or owner doesn't receive adequate client cooperation in assisting with the job.

Many accountants undertake engagements based on price estimates to which they agree with the client. Often, these engagements appear routine when you estimate the price. Perhaps the firm has done this engagement for several years and with no significant problems. Or you have done engagements for other clients who resemble the new client. You estimate your price on assumptions about the conditions you will face in performing the service. One assumption is the degree of client cooperation and/or client preparedness. Sometimes you discover the bad news after the engagement has begun: The client does not cooperate or is not prepared. In such cases, the job takes longer and costs run higher than estimated.

Example: A firm audits a nonprofit for three years with fees of \$2,500 to \$2,950? The firm quoted the fourth year at \$2,950. The in-charge did substantial work to get the records in shape to audit and standard charges ran over \$4,000. The person in charge (PIC) only learned about the overrun when he reviewed the file in the office—after the audit was complete. The PIC told me, “The in-charge should have told me when he found the client’s books in bad shape.” Whose fault was it? The in-charge or the PIC? Does it matter? The PIC must take responsibility to ensure the employees know what to do and what not to do.

The client planning conference and employee planning conference can prevent this problem. Too often, CPAs assume that client personnel will be freely available to analyze accounts, investigate confirmation exceptions, pull customer or vendor files, and prepare worksheets. In many cases, that is wishful thinking. The client’s employees have responsibilities that continue even if the outside CPAs are there. Without clear agreements with the client about assistance, it does not always happen. That is why the *two* planning conferences are so important.



CAUSE 7: UNWILLINGNESS BY THE ACCOUNTANT TO CONFRONT THE CLIENT

The seventh cause of unplanned write-downs is an unwillingness to confront the client on important issues. Unnecessary write-downs certainly qualify as an “important issue.”

Many accountants will do almost anything to avoid conflict. They are almost terrified at the thought of losing a client. They will take a large write-down—even a write-*off*—in preference to confronting a client.

As I mentioned earlier, accountants often hide bad estimating, bad supervision, bad client management, or lack of courage by blaming their write-downs on inefficiency or bad scheduling. In reality, those circumstances do not occur as often as we pretend. Ron Weiner has stated, if the job has gone over budget three years in a row, or if you have lost money on the last three engagements of this type, it is time to rethink the prices.

This issue is closely related to “inadequate skill in managing the client relationship.” Why? Accountants who do not know how to manage their clients ultimately wind up unable to confront them on important issues.

I discussed the importance of having two planning conferences—one with the client and one with your employees.

Without a planning conference, the accountant sometimes feels guilty for overruns—even those caused by client personnel who were derelict in their accounting duties. The guilt makes the accountant avoid confronting the client with bad news until the engagement is over—or the accountant may *never* tell the client about engagement problems.

If the accountant does tell the client about the extras, the client may or may not pay. A client caught off guard will be at least miffed and possibly angry enough to take future

business elsewhere. A nasty client loss makes accountant gun-shy, and he or she may begin react to this kind of engagement problem by simply turning away from it, i.e., avoiding the client. This dwindling spiral of loss of self-confidence causes many accountants to simply absorb losses rather than deliver bad news and risk losing the client.

Remember, clients will appreciate you more as a business adviser if you run your own practice in a businesslike manner. That is why I remind you to play the offense, not the defense. As soon as you know or can anticipate a problem, take the initiative to call the client. The planning conferences give you the basis on which to communicate with the client. Think of these communications as *progress reports*.

But what do you do if you did not have a planning conference?

That makes your situation tougher, but you still may have a chance. The sooner you act, the better. Lock the barn door before the horse gets out. If a client's books are in bad shape, meet with the client *before* you do any more work. As you explain the situation to the client, make your words a reminder that this is the client's problem, not yours. Say, "*Your* bank accounts have not been reconciled for the last six months." Then ask, "What do *you* intend to do about it?" Since it is the client's problem, it is the client's responsibility. The client may wish to engage you *for an extra fee* to fix the situation, but it is not part of the original engagement, or the original price estimate. That is when you discuss a change order.

EXHIBIT 7-1: SAMPLE CLIENT TIME BUDGET¹

	<i>Budget</i>			<i>Actual</i>	
	<i>Initial</i>	<i>Hours</i>	<i>Amount</i>	<i>Hours</i>	<i>Amount</i>
Fieldwork					
Assistant			\$		\$
Senior					
Team leader					
Report Preparation and Review					
Assistant					
Senior					
Team Leader					
Partner					
Report Review					
Tax Review					
Administrative					
Other					
Total					

ENGAGEMENT LETTER

Quote: \$ _____ to \$ _____ Prepared by: _____ Date: _____
 Approved by: _____ Date: _____

¹ Keller, Rita. "Engagement Assignment, Monitoring, and Processing," Chapter 205 of the *Management of an Accounting Practice Handbook*. New York: American Institute of Certified Public Accountants, 2000, Exhibit 205-2, page 13.

EXHIBIT 7-2: SAMPLE COST-EFFECTIVE SERVICE/WORK CODES

	Bookkeeping and Compilation		Financial Statements		Tax			Financial planning	Management consulting	Litigation support
	Reviewed	Audited	Individual	Business	Planning	Financial planning	Litigation support			
	100-199	200-299	300-399	400-499	500-599	600-699	700-799	800-899		
Planning, Develop Program	001	201	301	401	501	601	701	801		
Research	002	202	302	402	502	602	702	802		
Supervision and Review	003	203	303	403	503	603	703	803		
Team Conferences	004	204	304	404	504	604	704	804		
Client Meetings, Interviews	005	205	305	405	505	605	705	805		
Telephone Conference	006	206	306	406	506	606	706	806		
Correspondence	007	207	307	407	507	607	707	807		
Clerical, Typing, etc.	008	208	308	408	508	608	708	808		
Travel	009	209	309	409	509	609	709	809		
New Client Setup	010	210	310	410	510	610	710	810		
Interim Write-Up/Data Entry	011							811		
Year-End Write-Up	012									
Year-End Adjustments	013	213								
Manual Check Preparation	014		314	414	514	614				
Lead Schedules	015	215								815
Document Accounting System		216					716	816		
Test Internal Controls		217								
Cash and Bank Reconciliation	020	220	320	420	520	620	720	820		

Other Current Assets	021	121	221									821
Account/Reconciliation and Allowances	022	122	222									822
Notes Receivable	023	123	223									823
Inventory	024	124	224									824
Property, Plant, and Equipment	025	125	225									825
Depreciation and Depreciation Schedules	026	126	226	326	426	526	626	726				826
Other Assets and Amortization Schedules	027	127	227	327	427	527	627	727				827
Accounts Payable	028	128	228	328	428	528	628	728				828
Unrecorded Liabilities, Other Accruals		129	229	329	429	529	629	729				829
Income Taxes	030	130	230	330	430	530	630	730				830
Long-Term Debt	031	131	231				631					831
Other Liabilities	032	132	232									832
Equity	033	133	233									833
Retained Earnings	034	134	234									834
Commitments and Contingencies		135	235									835
Sales and Revenues		136	236									836
Payroll and Employee Benefits	037	137	237									837
Calculate Paycheck and Payroll Tax Deposit	038											
Analytical Review		139	239									839
Financial Statement Preparation, Report Writing	040	140	240			540	640	740				840
Review of Prior Periods	041	141	241	341	441	541	641					841
Footnotes, Disclosures	042	142	242									842
Tax Credits	043	143	243	343	443	543	643					843

(continued)

EXHIBIT 7-2: SAMPLE COST-EFFECTIVE SERVICE/WORK CODES (CONTINUED)

	Financial Statements		Tax				Litigation support		
	Bookkeeping and Compilation	Reviewed	Audited	Individual	Business	Planning		Financial planning	Management consulting
	000-099	100-199	200-299	300-399	400-499	500-599	600-699	700-799	800-899
Tax Carryovers	044	144	244	344	444	544	644		844
Estimated Tax	045	145	245	345	445	545	645		
Income Tax Preparation				350	450				
Trust Return Preparation					451				
Amended Returns				352	452				852
Multiple State Returns				353	453				853
Computer Charge	054	154	254	354	454	554	654	754	854
Tax Audit				355	455				
Estate Tax Preparation				356					856
Partnership Tax Preparation					457				857
Pension Plan Return					458				858
Payroll Report Preparation	059			359	459				859
Sales Tax Returns	060			360	460				860
Worker's Compensation Reports					461				861
Prepare K-1s, 1099s, and 1098s					462				
SS-4, Other ID Requests	063			363	463		663		

W2, W3 Preparation	064																			
Extensions	065								365	465										
Tax Projections, Estimated Taxes									366	466	566	666								866
Liquidation Planning											567									867
Estate Tax Planning									368											
Financial Plan Analysis												669								869
Business Valuation															770					870
Purchase Investigation															771					
Loan Negotiations															772					
Budget, Forecast, Projection															773					873
Money-Saving Ideas	074			174	274				374	474	574	674			774					
Resolve IRS and State Tax Issues	075								375	475										
Buy-Sell Agreements																				
Rework (Firm Error)	088			188	288				388	488	588	688			788					888
Rework (Client Error)	089			189	289				389	489	589	689			789					889
Chargeable Extras	090			190	290				390	490	590	690			790					890
Administration and Collections	091			191	291				391	491	591	691			791					891
Other	095			195	295				395	495	595	695			795					895

EXHIBIT 7-3: SAMPLE CLIENT PLANNING CONFERENCE FORM

Date: _____

Client representative: _____

CPA firm representative: _____

The purpose of this planning conference is to ensure agreement on the following items:

What work is contemplated in the fee estimate or time budget (with special emphasis on items: (1) we did last time that we now want the client to do; (2) included in the fee last time that are not included now; and (3) other differences this year.)

What work is specifically excluded, or will be charged extra

Client personnel responsibilities for the successful completion of the engagement

Client personnel name: Responsibility:

_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____

How we will determine the fee

Payment terms

EXHIBIT 7-4: SAMPLE STAFF PLANNING CONFERENCE FORM

Date: _____

Persons present _____

The purpose of this planning conference is to ensure agreement on the following items:

What work is contemplated in the fee estimate or time budget (with special emphasis on the following items):

1. What we did last time that we now want the client to do
2. What was included in the fee last time that is not included now
3. Other differences this year.

What work is specifically excluded, or will be charged extra

Team member responsibilities for the successful completion of the engagement

Team member:

Responsibility:

Time budget:

How we will determine the fee

Payment terms

CHAPTER 8

HOW TO SET THE RIGHT STANDARD CHARGEOUT RATES

One widespread misconception in most accountants' thinking is that setting prices is a mathematical process based on analyses of overhead costs, salaries, competitors' charges, and so forth.

KEY POINT: Setting prices is a marketing decision.

The amount the time-keeping system produces influences the amount you charge because of the anchor effect, introduced in Chapter 5, "How to Discuss Prices With Clients." So, most accountants assume the time-keeping system indicates approximately the amount they *should* charge. This is not true. The amounts used in your time-keeping system are simply a management decision. You could cut those rates in half, or double them, and *they would not change the value of the service* to clients.

KEY POINT: Setting standard chargeout rates is a management decision.

So do not confuse the *prices* you charge clients with the *standard chargeout rates* in your time-keeping system. Standard chargeout rates measure *standard revenue*, or *opportunity cost* to perform the work. They measure, if you will, the *effort* the firm invested in the engagement; they do not measure the *value* of that engagement to the client.

You cannot offer a service that costs you more to provide than clients will pay. For example, you are technically capable of washing your client's windows. But if your cost of employees is more than the going rate for window washers, you cannot offer that service profitably.

KEY POINT: The principal (and often overlooked) purpose of standard chargeout rates is to determine the profitability of serving each client. Second, using the discipline of standard chargeout rates allows the firm to determine the profit contribution of each responsible person's ledger. Third, using standard chargeout rates allows the firm to determine the revenue contribution of each time-keeper.

But chargeout rates also represent an *opportunity* cost to the extent you work on clients who value your services less and who will not or cannot pay as high a percentage of standard fees as other clients.

Your goal should be for all your people to work at their highest professional level for clients that appreciate and can afford that level of service.

You may attain that ideal level of performance only 10 percent of the time; your employees may attain it only 30 to 40 percent. But that is the goal. If you achieve the goal, for most of you, that deserves a chargeout rate considerably higher than the one you currently use.

Ask yourself, “What chargeout rate do I deserve if I practice at my *ideal scene* (the top 10 percent of your capabilities)?

After all, this is the ideal scene, and you do not achieve that very often. But the reason most people do not achieve their goals is that they don't have any. If you keep the goal constantly in sight, it is easier to attain.

For this purpose, think of your chargeout rates as the amount of value you *could* deliver to clients if you and all the people of your firm worked at their highest professional level, on valuable services, for clients that appreciate and can afford that level of service. Think of it as an “opportunity cost” accounting system that measures the degree to which you do not achieve your ideal.

Imagine a CPA who charges 1,500 hours per year and generates revenues of \$300,000 for an average effective rate of \$200 per hour. Let's call her Alicia Accountant. Not all of Alicia's hours were worth \$200. In fact probably few were; the majority of her hours were worth more or less than \$200, but she averaged \$200 for the year.

Further imagine that you can sort all 1,500 of Alicia's hours by value from top to bottom. Add them all up and they total \$300,000. If you count down from the top and total the top 10 percent, or 150, of Alicia's hours, how much do you think each hour is worth on average? Most of my participants say, about 30 to 40 percent above average, say, \$260 to \$280 per hour.

Now imagine you can count up from the bottom and total the bottom 10 percent of Alicia's hours. How much do you think these bottom 150 hours were worth, on average? Most participants say between 50 and 70 percent of average, say \$100 to \$140 per hour.

If you looked at the type of work Alicia Accountant did for her *top 10 percent* hours, you would probably find a preponderance of tax planning, business advice, and other value-added services (VAS). Likewise, her bottom hours are probably spent on bookkeeping, payroll taxes, compilations, reviews, and possibly audits.

If Alicia does a good job for her bookkeeping clients, but the market won't bear her standard rates, it makes no sense to kid ourselves by assigning a higher standard than she can ever achieve. Likewise, the market for tax advice and other VAS is always quite strong and using the same standard chargeout rates for these services as those she uses for bookkeeping gives her no target to stretch for, so she probably undercharges for those services.

KEY POINT: Because your efforts have different values, your standard chargeout rates should differ also.

KEY POINT: For most clients I recommend that they set tax and VAS rates 25 percent higher than accounting and auditing and other mandatory service rates.



WHY THE 2-PERCENT RULE IS DEAD

Many firms use 2 percent of average monthly compensation as their standard chargeout rate per hour. (This formula was discussed in Chapter 2, “How Much Do You Really Earn?”) The 2-percent formula was derived from the rule that firms should get revenue from employees of three times their compensation. The old precept was “one-third salary, one-third overhead, and one-third profit.”

Example: An employee paid \$36,000 per year should generate gross fees of three times salary (\$108,000 in this case). If the employee works 1,800 chargeable hours, the hourly chargeout rate is \$60. That is 2 percent of the \$3,000 monthly salary.

If the firm also invoices 100 percent of standard fees, direct labor is 33 percent of revenues (\$108,000 of revenues divided by \$36,000 of salary). Here is the math:

Monthly salary	\$ 3,000
	<u>X 2%</u>
Chargeout rate per hour	\$ 60
Assumed chargeable hours	<u>X 1,800</u>
Gross fees	\$108,000
Assumed realization	<u>X 100%</u>
Net sales	<u>\$108,000</u>

The 2-percent rule has been around since at least the 1960s. But is it still appropriate?

The rule is based on three assumptions:

1. 1,800 chargeable hours *with no overtime*
2. Overhead equals salary cost
3. 100-percent realization

Those assumptions may have had some validity in the 1960s.

Today, with increased requirements for technical education, time off, and management and marketing time, it is almost impossible to yield 1,800 chargeable hours without significant overtime and even with overtime it is a challenge to achieve.

In my experience—except for firms with chargeout rates significantly less than 2 percent of monthly salary—most firms overall invoice at less than standard rates, usually between 90 and 95 percent.

As a result, few firms get anywhere near a three times multiple on their salary costs.

EXAMPLE: One client, before I began working with them, had a staff accountant with a base annual salary of \$41,600, and a chargeout rate of \$66, 1664 expected chargeable hours, and 94-percent realization.

Chargeout rate per hour	\$ 66
Chargeable hours	<u>X 1,664</u>
Gross fees	\$109,824
Realization	<u>X 94%</u>
Net sales	\$103,235
Divided by salary	<u>\$ 41,600</u>
Actual billing multiple	<u><u>2.48</u></u>

What multiple of salaries does your firm generate?

Exhibit 8-1, "Sample Profile Firm Annual Billing Multiple," calculates the profile firm's actual annual billing multiple with a column for you to calculate your actual multiple for the firm. You might be surprised.

Total **net fees** below differs from net fees on the income statement because I excluded support personnel. You shouldn't expect to get a three-times multiple for support personnel. Including them in the total personnel multiple would distort the number by making it even lower.

Although much is said about today's professional environment increasing overhead, I have not found that to be the case. Salaries have also increased and the same ratios seem to apply for most firms. Overhead is still running about 100 percent of direct salaries *if you include the fair-market value of owners' salaries*.

I have found that chargeable hours have decreased. So firms have less hours available to cover overhead.

Firms that use inadequate standard chargeout rates earn inadequate profits. If your standard chargeout rates are inadequate, obviously, you should adopt a new formula. But what formula is appropriate? There are many ways to capture your opportunity costs in a new formula.



THREE-STEP FORMULA FOR SETTING STANDARD CHARGEOUT RATE

Here is one approach to set appropriate standard chargeout rates:

1. *Determine your overhead and direct salaries (include owners' salaries).* Exhibit 8-2, "Sample Overhead Calculation Form," calculates your firm's overhead figures. Note that, to the extent you do not charge clients for support employee services, those support salaries are overhead for the technical personnel.

This number differs from the analysis in Exhibit 2-11, "Sample Profile Firm Overhead," of Chapter 2, because Exhibit 2-11 included all support salaries in overhead. The analysis presented in Exhibit 8-2 reduces overhead by net sales produced by support personnel.

2. *Determine an appropriate markup on your direct salaries and overhead. In other words, decide how much revenue you should generate with your current cost structure.* Most accountants agree that the “one-third profit” part of the 2-percent rule is a realistic target. That means you can view the target markup as 50 percent markup on the sum of direct salaries and overhead. Working with that assumption, Exhibit 8-3, “Sample Target Markup Calculation Form,” calculates the target markup and net sales for the profile firm’s targets with a column for you to calculate your own firm’s target.
3. *Increase standard chargeout rates across the board to achieve your targets for direct personnel.* Exhibit 8-4, “Sample Standard Chargeout Rate Calculation Form,” calculates the average standard chargeout rate increase necessary for the profile firm and your firm.

EXHIBIT 8-1: SAMPLE PROFILE FIRM ANNUAL BILLING MULTIPLE

	PROFILE FIRM	YOUR FIRM
Net fees (Standard fees from Exhibit 2-3 x realization*)		
Technical Staff	\$1,393,269	
Owners	462,720	
Total Direct Personnel	\$1,855,989	
Salaries		
Technical Staff (from Exhibit 2-1)	\$560,000	
Owners (from Exhibit 2-6)	268,125	
Total Direct Personnel	\$828,125	
Annual Billing Multiple (Net Fees Divided by Salaries)		
Technical Staff	2.49	
Total Direct Personnel	2.24	

*realization=96.4%=100%-3.6% (Write Downs from Exhibit 2-3)

EXHIBIT 8-2: SAMPLE OVERHEAD CALCULATION FORM

	PROFILE FIRM	YOUR FIRM
Overhead		
1. Salaries, Support Employees	\$87,500	
2. Less, <i>Net</i> Sales Generated by Support Employees (from Exhibit 2-3)	26,028	
3. [Line 1 minus line 2] Net Salaries, Support Employees	61,472	
4. Other Costs and Expenses (All Generally Accepted Accounting Principles Expenses Plus Interest on Accrual-Basis Capital):		
5. Imputed Interest on Owners' Capital	30,750	
6. Consultation, Unallocated	12,000	
7. Data Processing, Unallocated	37,000	
8. Employees	142,000	
9. Facilities	160,000	
10. Practice Development	34,500	
11. Other Operating Expenses	100,500	
12. Nonoperating Expenses	35,000	
13. [Sum of Lines 3 minus Lines 12] Total Overhead Costs	613,222	
DIRECT SALARIES		
14. Owners	268,125	
15. Technical Staff	560,000	
16. Paraprofessional Employees	—	
17. [Line 14 plus Line 15 plus Line 16] Total Direct Salaries	\$828,125	
18. [Line 13 divided by Line 17] Overhead as Percent of Direct Salaries	74.05%	

EXHIBIT 8-3: SAMPLE TARGET MARKUP CALCULATION FORM

	PROFILE FIRM	YOUR FIRM
1. Direct Employee Salaries	\$ 560,000	
2. Overhead (Line 18, Exhibit 8-2 times 1, above)	414,680	
3. [Line 1 plus Line 2] Total Direct Costs	\$ 974,680	
4. Times Markup Percentage	50.00%	
5. [Line 3 times Line 4] Target Markup	\$ 487,340	
6. [Line 3 plus Line 5] Targeted Net Sales From Direct Employees	\$1,462,020	
7. Divided by Realization	96.40%	
8. [Line 6 divided by Line 7] Targeted Standard Fees From Direct Employees	\$1,516,618	

EXHIBIT 8-4: SAMPLE STANDARD CHARGEOUT RATE CALCULATION FORM

	PROFILE FIRM	YOUR FIRM
1. Targeted Standard Fees From Direct Employees	\$1,516,618	
Direct Employee Chargeable Hours (from Exhibit 2-3)		
2. Technical Staff	22,950	
3. Paraprofessional employees	0	
4. [Line 3 plus Line 4] Total	22,950	
5. [Line 1 divided by Line 4] Required Average Chargeout Rate per Direct Person	\$ 66.8	
6. Current Average Chargeout Rate per Direct Employee (from Exhibit 2-3)	\$ 62.98	
7. [Line 5 divided by Line 6 minus 1.00] Increase Necessary	4.93%	

CHAPTER 9

MOTIVATING STAFF TO BILL WHAT THEY ARE WORTH

The typical accounting firm invoicing system includes many of these characteristics:

- Owners do the invoicing, or at least approve all invoices before clients see them.
- They invoice based on standard charges plus some out-of-pocket expenses.
- They send invoices after the engagement is finished—sometimes long after.
- Even progress invoices are sent only after the engagement is well begun and much of the cost is incurred.
- Often, the entire invoice is sent only after the engagement is complete.
- Clients don't know the price of the engagement in advance. But, as Charles Larson and Joseph Larson point out, they nevertheless have a definite idea of what the price should be.
- Even though the firm completes an engagement in the early part of the month, the invoice goes out after the first of the following month—again, sometimes long after.
- Time sheets are supposed to be recorded daily, but they are frequently late, especially from the owners.
- Work in progress (WIP) runs are delayed for several days after the end of the accounting period.
- Some owners don't invoice on the first day the WIP is available.

Do any of these characteristics look familiar? The more of them you have in your firm, the more trouble you will have making money.

There are steps you can take to encourage more effective billing. These steps include:

- Define chargeable and nonchargeable time.
- Use the 50-minute hour.
- Adopt daily time reporting.
- Round up, not down.
- Use peer pressure.
- Require second-owner approval on substandard invoices.
- Invoice promptly.
- Invoice progressively.
- Let employees draft invoices.
- Do not compromise on prices.

Each of these techniques is discussed below.



DEFINE CHARGEABLE AND NONCHARGEABLE TIME

Firms often encounter a problem with owners and employees who give away the firm's services to clients by not recording all their chargeable time—actually donating such services to clients.

Over 20 years ago, Stephen Weinstein of Siskin, Shapiro & Company in Hartford, Connecticut, noticed that certain employees and owners had lower chargeable time than normal.¹ Discussion disclosed there was a considerable difference of opinion among various partners and employees as to the definitions of chargeable time and nonchargeable time. It was immediately apparent that firm personnel were not charging time consistently.

Over the last 20 years, my consulting experience shows this holds true at most other firms. For example, I interviewed an entry-level employee at one firm. She normally charged only seven hours in an eight-hour day. She explained that she figured that coffeekbreaks, visits to the restroom, conversations in the hallway, etc., were “nonchargeable” time that amounted to an hour a day.

In another example, an owner in a two-owner firm told me he normally did not charge clients for time spent at lunch. He also confided that he normally did not charge clients for telephone calls. It was no surprise to me when he also admitted that certain of his clients had discovered this practice and were now taking advantage of his generosity. His fellow owner, on the other hand, charged all such time, and their differences were a constant irritation. The two partners eventually broke up.

Like Weinstein, if you were to investigate in your firm, you might discover that a large percentage of your employees do not understand the nature and importance of accurate time-keeping procedures. Further, you might discover that some of your fellow owners work under different philosophies of how to charge time and how much time to charge. Less-experienced employees tend to heavily undercharge. Similarly, owners who believe that the firm has set their billing rates too high will tend to underreport their time. As Weinstein observed, “Their approach could best be described as, ‘*When in doubt, show the time in one of the nonchargeable categories*’” [*emphasis supplied.*] The particular problem areas are:

- *Business-related lunches with clients.* Some people have problems differentiating the social and business aspects of client lunches. They also have difficulty deciding whether or not to charge for the time depending on whether the client paid for lunch. Similarly, they have difficulty determining whether to charge the client for the expense of the lunch if the accountant pays for the lunch.

¹ Stephen Weinstein, CPA, “Survey on Chargeable Time,” *The Journal of Accountancy*, August 1982, pages. 87-90.

- *Business-related dinners or other after-hours activities with clients.* The same considerations as business lunches exist, plus the complication of whether or not spouses accompany the CPA and client.
- *Time spent researching a client problem.* Some accountants exhibit a strong tendency to view their normal performance as superheroic. They rationalize not recording all their time because they think they should have done better. As a result, they underreport their time.
- *Evaluating their own productivity.* Similarly, some accountants, particularly the less-experienced ones, tend to evaluate their own performance and usually find it wanting.
- *Interruptions at work.* Problems often occur in one department with accountants being frequently interrupted with questions by personnel from other departments. Owners, too, are often interrupted by employees with routine questions regarding clients for whom the owner is responsible and on whom the employee is working. Often, the higher level people will not keep track of these interruptions and, as a result, they accumulate a lot of time that was spent on clients but is shown as nonchargeable. The cure for this: Before responding to any question, your people should be required to immediately ask which client should be charged for the answer.
- *Travel time.* Particular problems are travel from one client to another, travel outside of normal office hours, and travel outside your normal market area.

Practical Tips: Adapt Exhibit 9-1 to your own firm, and ask your employees and owners to complete it. You might be surprised at the answers. Use the tabulation of results as the agenda for a firm meeting.

Exhibit 9-1, “Sample Time-Recording Survey,” is an illustrative questionnaire and Exhibit 9-2, “Sample Results From Time-Keeping Survey,” is the actual results of a questionnaire used on an assignment for a 70-person midwestern CPA firm. The firm selected a random sample of 20 people from all personnel levels.



USE THE 50-MINUTE HOUR

Exhibit 9-2 confirms that some accountants are quite literal when it comes to charging time; they adopt a *stopwatch* approach to time keeping. They think that if they don’t have their hands on the keyboard, concentrating on the client, then the time isn’t chargeable. This tendency seems especially prevalent at firms that charge tenths of an hour rather than quarter-hours. The tenth-of-an-hour increment engenders an attitude of exactitude that does not reflect the realities of professional practice.

Also, some accountants think of themselves as machines that should not have normal human needs for refreshment, visits to the bathroom, and brief social interactions with coworkers.

In one interview, an employee was asked how he determined how much time to charge. He proudly displayed his digital wristwatch with a built-in stopwatch. "When I start to work on a client, I punch the stopwatch button. When I finish, I punch it again, and it tells me exactly how long I've worked on that client." If he then got a cup of coffee or went to the bathroom between clients, he would not start his stopwatch until he picked up the file for the next client.

Another employee in the same firm asserted, "I never have eight hours chargeable, even if I'm busy all day. I always put at least three-tenths of an hour to [a nonchargeable category]." Others in the firm had similar stories. As a result, all employees ended each day with between three-tenths of an hour and 1.1 hours unaccounted-for, which they plug to a non-chargeable category. No wonder it was dubbed the "stopwatch firm."

KEY POINT: Personal interviews and reviews of actual time records show that some people have a policy of charging at least one hour a day to such unspecified nonchargeable activities, *even if fully occupied all day long on chargeable engagements!*

In fact, the AICPA recognizes 50 *contact minutes* (minutes in a classroom) as one hour of continuing professional education (CPE) credit. Universities have 50-minute classes, for which students get one hour of credit. Marriage counselors and other consultants use 50-minute counseling sessions for their hourly rate. And most firms set their billing rates on the (unstated) assumption that the eight-hour workday will generate eight chargeable hours. They just don't explain that to the employees and all the owners.

A short break or a brief conversation with a coworker doesn't make the time nonchargeable. If a person is productively occupied for at least 50 minutes of the hour, one hour should be charged. Using the 50-minute hour will allow you to capture more chargeable time that is not getting billed.

Practical Tips: Adopt the *50-minute hour* as the firm's time-keeping philosophy. Hold an "all hands" meeting to explain to all firm personnel that normal human physical and social needs are recognized in setting billing rates and that the firm expects personnel to have normal breaks in their work routine each day. Accordingly, if they are otherwise productively occupied the entire day, the firm expects them to record eight hours to chargeable categories.

Occasionally, using the 50-minute hour causes a person to end the day with more than eight hours recorded. This happens most often to people who handle many files each day (such as support personnel or technical quality reviewers) and who charge a minimum of one-quarter hour to each file. It is okay to charge more than eight hours in an eight-hour day. After all, sometimes you charge less than eight hours if you have worked on clients all day, don't you? We need to think of our time-keeping practices as "presenting fairly" how we spent the firm's resources.



ADOPT DAILY TIME REPORTING

Even if you stop donating time to clients and adopt the 50-minute hour, you could still be losing productivity because of the fallibility of human memory and misunderstandings about firm policy. One firm increased chargeable hours over 10 percent simply by having personnel record their time daily. An informal survey covered over one hundred executives who have gone to daily time reporting. All but one reported significant increases in chargeable time, ranging from 6 to 20 percent.

Since over 90 percent of all firms have now adopted daily time reporting, there is no need to belabor the point. Nevertheless, some firms still allow their people to wait until the following day to record their time.

Countless interviews with owners and employees lead to the conclusion that many people are careless about recording their time as they go. If time is typically turned in the following morning, some people will wait until that morning to record their time. Then they try to remember what they did the previous day. Faulty human memory, along with the tendency to resolve all doubt in favor of the client, mean that a lot of chargeable time gets lost.

Also, if time records are prepared the following morning, accountants tend to charge a minimum of one-quarter to one-half hour to a nonchargeable code for the time spent entering their time. If time records are done at the end of each day *and recorded before leaving for the day*, no time is charged to a nonchargeable code for time reporting.

Practical Tips: Have everyone who is in the office at the end of the day record their time before they leave—not first thing the next morning, but before they leave for the day. Those working out of the office can telephone the information. Those working past office hours out of the office can report their time first thing the following morning, but they should be the only exceptions. Then have the **firm administrator** review all time records for accuracy and conformance to firm policy. If the firm administrator sees time charged to a nonchargeable category by an employee who would be expected to be 100 percent chargeable, the administrator should immediately question the employee. Frequently, the employee will have spent the time working on a client, but will have made a unilateral decision not to charge the time.

Example: I recommended that the “stopwatch firm” described earlier adopt both daily time reporting and the 50-minute hour. I followed up three months later and learned that their utilization had increased 19.9 percent.



ROUND UP, NOT DOWN

When I speak on billing, I often ask participants, “How many of you actually invoice to the penny? That is, if the WIP run says \$1,782.50, you will invoice \$1,782.50.”

Invariably, when asked that question, between 95 and 100 percent of participants over the years indicate that they do not invoice the amount on their WIP. Instead, they usually round to an even amount.

Then, they are asked, "Imagine you have an engagement for a small corporate tax return. They have been a client for several years. The WIP was \$1,782.50. How much would you actually invoice, assuming it was a routine engagement that ran into no problems and the WIP amount was about the same as last year?" The participants give answers that are posted on a flip chart. Answers normally run from a low of \$1,600 to a high of \$1,900, with most answers falling in the \$1,700 to \$1,800 range.

Most participants round down, and most of them would round \$1,782.50 down to \$1,700 or \$1,750. A minority of participants round up and most of them would round up to no more than \$1,800.

Then, it is pointed out that that, in this case, the difference between rounding up and rounding down is \$100, less than 6 percent. If you were to charge \$2,000, your client might have a question about the amount. If you were to charge \$1,500, your fellow owners might have a question or two. But what about the difference between \$1,700 and \$1,800. I ask, "Do you think it matters to your client whether your charge is \$1,700 or \$1,800?"

Most everyone agrees that small difference is insignificant to clients. But the typical owner sends out several hundred invoices each year.

KEY POINT: Round up all invoices over \$1,000 to the next \$100. Round up all invoices between \$500 and \$949 to the next \$50. Round up invoices less than \$474 to the next \$25.

What would be the effect if each of those were rounded *up* instead of *down*? The answer may be as many as 500 invoices a year times \$50, or \$25,000 a year for each owner!



USE PEER PRESSURE

You can increase realization simply by getting your owners to invoice more. It sounds simple, and it is. But simple does not always mean easy.

One Michigan firm was realizing only about 70 percent of **standard** when I began working with them. And their rates were not high; in fact, I had them raise the owner rates. They also developed a list of what they called *underachievers*—specific clients who yielded less than 75-percent realization. The list was circulated to all owners each month and owners began to take pride in getting clients from the list for whom they were responsible.

This increased profits \$350,000 in just four months. The simple expedient of passing out each owner's numbers each month allowed peer pressure to do the rest.

As realization rose, they increased the underachiever threshold to 80 percent, and then 85 percent.



REQUIRE SECOND-OWNER APPROVAL ON SUBSTANDARD INVOICES

A Utah firm was shown how to get their owners to invoice more with no increase in new business, no change in costs, no improvement in efficiency. Using this simple procedure, they began to charge more for the same work and increased their realization from 87 to 95 percent in less than a year.

The average owner's income shot up 15 percent.

Here is how they did it: The firm's owners had always invoiced "in a vacuum," that is, invoicing without recourse to or discussion with other owners and employees. They had a typical system. Each month they distributed the WIP runs for each client directly to the person in charge (PIC) for each client. Each PIC then drafted invoices. They were typed, reviewed by the same PIC, and mailed. PICs (who were all owners) normally did not confer with each other on how much to invoice.

They were told to, instead, require that any invoice with a write-down of more than 5 percent be approved by the managing owner (who happened to be a bold biller), or at least by some second owner. This allowed the managing owner to discuss the value of the work with the invoicing owners and thereby lead them to see the value of the work. The managing owner also gave them a little courage, as needed, to confront clients who were low in profitability.

The firm went one better; they began to observe "billing Monday." The first Monday of each month, sandwiches were brought into a conference room, and all ten owners met over lunch to do their invoicing. And they didn't leave until it was finished.



INVOICE PROMPTLY

There are five reasons a firm needs to invoice client promptly, and they are described in the following sections.

1. WIP Depreciates

Accountants are good at figuring depreciation. They can tell a client that computer equipment depreciates 33 percent a year. They can tell clients to write off their office furniture at 10 percent a year.

How fast does the value of WIP depreciate?

The *value* is, "what clients are willing to pay for the service they have just received."

KEY POINT: The value of a service rendered declines rapidly once the service is completed.

If you wait 30 days to invoice your client, the value he or she perceives may have declined by 10 percent, 20 percent, or more.

That is why I recommend *event billing*—sending an invoice to a client after every significant service event.

Example: Say you send a client their tax return on the fourth of the month or their financial statements on the tenth of the month. Why wait until the first of the following month to send the invoice?

KEY POINT: Your invoice should arrive in the client's hands while the tears of appreciation are still wet on their cheeks.

2. Clients Want to Know What They Owe

People get nervous when they know they owe money but don't know how much it is. You do them a disservice if you delay the inevitable.

I once lost a client because I delayed sending her invoice. She was a freelance writer. I sent her the tax return. She called to thank me and asked where the invoice was.

I told her, "Don't worry about it, I will send it soon."

A couple of weeks later she called about the bill again. "I have money now," she explained. "My business is feast and famine, and I am trying to pay all my bills while I have the money. If you wait much longer to send my invoice, I may not have the money to pay you."

Still I delayed. I finally sent her the invoice a couple of weeks later. As I remember, it was only about \$350 or so. She sent me a check and a thank you note by return mail, but she never came back.

She was distressed at the idea of owing money when she had the money to pay. She liked to be out of debt, and I made that impossible by not sending her invoice.

3. You Get Paid More Quickly

This is so obvious that most people—even CPAs—overlook it. The sooner you invoice, the sooner they pay you. It's better to have the money in your bank than in theirs. This reduces bad debts.

4. Clients Remember What You Did

Even if you prepare detailed invoices, you seldom can include all the services you performed. And, even if you can, the invoice alone is insufficient to remind the client of the good feelings they got from your good service.

Send the invoice while the client can still remember how good they felt when you helped them.

5. *You Can Remember What You Did*

No matter how detailed your service codes, your time-keeping system will seldom capture everything you did for a client, namely, the telephone consultations, the late-night calls, the office conferences, the memos you sent, the special reports you prepared.

Invoicing while these events are fresh in your mind helps you write a more complete, descriptive invoice.



INVOICE PROGRESSIVELY

There are five reasons to progress invoice.

1. Allowing WIP to Build Up Intimidates the CPA and Increases Write-Downs

It's emotionally easier to send a client an \$800 invoice than a \$1,800 invoice. And it's easier to send two \$6,000 invoices than one for \$12,000.

If you wait, the WIP builds and builds. After two or three months (or even after two or three weeks), the balance may get so large that the number itself intimidates you. This makes you write down the price even if you don't need to.

KEY POINT: Progress invoice at the end of each month to keep the WIP balance at a number that is easier for you to confront.

2. Clients Would Rather Pay Five \$1,000 Invoices Than One \$4,000 Invoice

Just as it is emotionally easier for you to send a small invoice, it is emotionally easier for a client to pay several small invoices than one large one.

KEY POINT: Make the arrival of your invoices a regular occurrence in clients' mail, not a remarkable event.

3. The Larger an Invoice Is, the More Difficult for Clients to Pay

There is a reason why automobile companies encourage buyers to lease or finance their cars. It's financially easier to make a series of small payments instead of one large one.

Learn from their example. Clients find it easier to write a small check. Make it easy for clients to pay you.

4. Invoices Over a Certain Size May Require a Second Signature to Pay

The treasurer may have to get a second signature for checks over \$5,000 or \$10,000. It's just one more delay in getting paid.

5. A Large Invoice at the End of an Engagement Invites Renegotiation of Fees

Waiting to send a large invoice after you have finished a long engagement tempts some clients to reopen price negotiations. Remember that after you finish the work, you have little leverage. Invoicing as you go—while more work remains to do—gives you the leverage to stop work.

As the client pays, he or she implicitly accepts your prices and waives the right to reopen the discussion.

So break your invoices into smaller chunks.



LET EMPLOYEES DRAFT INVOICES

Let employees draft invoices for routine or **mandatory services**. Naturally, PICs should approve all invoices before sending them out. Letting employees do the invoicing has four advantages, as described in the following sections.

1. It Is Good Training for Future Promotions

Someday, your employees may be PICs. That is probably your hope for most of your employees. Even if they never make it to become owners, at least they should learn to handle smaller clients as PIC.

Invoicing is an important part of serving a client. Let your employees practice invoicing under your supervision.

2. Employees Will More Likely Remember Any Extra Services Done

Often, clients authorize extra service during the regular engagement. Sometimes, these extras do not get documented in the engagement letter or by a change order. Often, they are simply too small to bother with. Occasionally, a client may simply agree directly with an in-charge for extra work.

Letting the in-charge prepare the invoice gives him or her a chance to charge for the extra work that you don't know about.

3. Employees Often Have More Courage Than the PICs

It seems strange that employees have the courage to invoice more than the owners — especially since they may have little or no direct financial stake in the amount of the invoice. Yet, some owners are predisposed to take write-downs (the “bashful billers”) and no amount of peer pressure or even financial penalties seems to change their behavior.

For these executives, it is better to let their employees prepare the invoices. Because of the anchor effect, even a bashful biller is less likely to reduce an invoice once it is already prepared.

4. It Makes Employees More Cost-Conscious and Thus More Efficient

If an employee knows that he or she is going to have to invoice the engagements they work on, this knowledge stimulates them to be more efficient and to document any extra work.



DO NOT COMPROMISE ON PRICES

When I had been in practice about four months, I got my first significant client, a real estate developer who had not filed tax returns for several years.

At that time, income tax laws were very favorable to real estate investors. My client was involved in several partnerships in which investors put up the money and he developed the properties. Because of the tax-shelter characteristics of his partnership interests, he knew he would not owe any taxes. Nevertheless, he had procrastinated for several years, and now he was getting nervous about it.

His records were a mess, and I spent about half my time each week at his office reconstructing his books. Whenever I came to a transaction that was not clear, I noted it for later followup. We had a standing appointment each Saturday morning in his office, at which I would go over the followup questions with him. Then, the next week I would work some more. Also each Saturday, I presented him with my invoice for services for that week, and he paid me.

This went on for a couple of months.

One week, I worked many more hours than normal on his affairs and presented him with an invoice that was about twice what the others had been. He looked at it and said, “That’s a lot of money.”

Picture this:

- I was 27 years old; he was in his forties.
- I subleased a single room from another CPA; the client’s office had a wood-burning fireplace, wet bar, ice maker, full bath, and a sauna.
- My net worth was about equal to his petty cash fund.

- I owed a mortgage and a car payment, I had two children, and my wife did not work. The client owned the office building where we were meeting.
- This client was about 75 percent of my practice. His business was paying my bills. There were over a thousand CPAs in public practice in Dallas. And every one of them was listed in the Yellow Pages.

Would you have been as nervous as I was?

But, I looked the client in the eye, smiled confidently, and asked, “Why do you think the invoice is too high?”

Imagine my surprise when this multimillionaire real estate developer physically flinched and answered nervously, “I didn’t say it was too high. I just said it was a lot of money.”

“Well, I did a lot of work this week.”

“No problem.” And he quickly wrote me a check.

Ten years later, when I sold my share of the firm to my partners, moved to Florida, and became a practice profitability consultant, this developer was still a client of my firm. And, in all those ten years, he never again commented on my prices a single time! (Which means, of course, that I was not charging him enough.)

I learned two valuable lessons from this event:

KEY POINT: First, listen to what a person actually says. My client *said*, “That’s a lot of money.” I *heard*, “Your price is too high.”

KEY POINT: Second, often *the client is more nervous about losing you than you are about losing the client.*

In this case, he was actually afraid I would quit and leave him hanging.

A few years later, I learned another valuable lesson about not compromising on prices. I lost a large audit client who tried to get me to work for less than I was worth. All employees have the right to quit their jobs if their boss insists on paying them less than the going wage. If you view your clients as your employers, we, too, have the right to refuse to work for less than other clients are willing to pay.

KEY POINT: One of the keys to my success has always been that I will not work for less than I am worth.

Oh my goodness! I lost that large client! Oh dear, what shall I do?

I’ll tell you what I did; I went out and got some more clients—better clients. The nice thing about losing a large client is that you have time to do more marketing. Yes, it took several new clients to replace the one lost one. But they were each better clients who valued what I did and were willing to pay fair prices.

EXHIBIT 9-1: SAMPLE TIME RECORDING SURVEY*

Instructions

This survey is intended to determine the time recording practices currently in use by various people in the firm. Please consider each question carefully. This is the best way to find out how time is being recorded and should reflect how you *actually* record time. Please do not answer what you *think* we want to hear; tell us what you would *actually* do in the situation described.

For each of the following hypothetical questions, indicate how you would charge the time described. Please complete this form and return it by _____.

We will soon update our policy manual on time reporting based on this survey. As part of this project, we will establish clear guidelines for accounting for time.

Name _____ Department _____

Years of public accounting experience _____

Years with our firm _____

	<i>Report the Time as:</i>	
	<i>Not Record the Time</i>	<i>Chargeable</i>
	<i>Number of Hours</i>	<i>Number of Hours</i>
1. During a regular workday at the client's office, you and the controller go to lunch. The lunch takes one and one-half hours. Most of the discussion is about the client's business.		
2. The same facts as as item 1, but the lunch takes one hour.		
3. The same facts as item 1, but the lunch takes two hours.		
4. The president of one of your clients asks you to dinner to discuss an accounting, tax, or business problem. The dinner takes two hours. Most of the discussion is about the client's problem.		
5. You are working at a client's office and encounter a technical question, which takes 20 minutes of research to answer.		
6. The same facts as item 5, except that you believe the research involved an area of practice you should have known.		
7. The same facts as item 5, except that you believe the research you did would have taken an average person (i.e., one not as knowledgeable as you) one hour to accomplish.		

 * This exhibit is adapted from the article entitled "Survey on Chargeable Time," by Stephen Weinstein, *Journal of Accountancy*, August 1982, pp. 87-90.

(continued)

	<i>Report the Time as:</i>	
	<i>Not Record the Time</i>	<i>Chargeable</i>
	<i>Number of Hours</i>	<i>Number of Hours</i>
8. The same facts as item 5, except the research took you one hour, you do not feel competent in this type of research, and you believe that it should have taken you about 20 minutes.		
9. You are working in the firm's office on client X. Another team member interrupts you to ask questions about a problem he or she is having with client Y (for whom you have no responsibility). The interruption lasts 20 minutes. Select only one of the following, and indicate how much time you would charge:		
Client X		
Client Y		
Neither		
10. The same facts as item 9, except the interruption lasts 10 minutes. Select only one of the following, and indicate how much time you would charge:		
Client X		
Client Y		
Neither		
11. During the day, you do not feel well and believe that your productivity was less than it should have been as a result of coughing spells, blowing your nose, trips to the bathroom, etc. You have worked on one client for the entire day, and the time lost due to illness is about one hour.		
12. The same facts as item 11, except that you have worked on four different clients during the day.		
13. During a typical workday at the client's office, you determine that you made trips to the coffee machine, bathroom, and water cooler, and placed a personal phone call, totaling about 15 minutes of nonclient personal time.		
14. The same facts as item 13, except you were working in your office all day on <i>one</i> client.		
15. The same facts as item 13, except you were working in your office all day on several different clients.		
16. You are under severe time pressure on an assignment. You do not want to go over budget. So, on one day, you bring some work home and spend one hour completing it.		

	<i>Report the Time as:</i>		
	<i>Not Record the Time</i>	<i>Nonchargeable Number of Hours</i>	<i>Chargeable Number of Hours</i>
17. The same facts as item 16, except you take work home on several days, i.e., one hour a day at home.			
18. The same facts as item 16, except you do enough work in one evening to complete a job due the next day, i.e., several hours.			
19. While working in your office, another person comes over to talk to you on a nonclient matter. He or she leaves 15 minutes later.			
20. A client decides to close their office an hour early on Friday. At that point, you have spent seven chargeable hours at the client's office. It's too late to return to the firm's office, so, you go home, where you work one hour to finish the day.			
21. During the day at the client's office, a client's employee gets into a conversation about a nonclient matter (i.e., a personal problem or sports). The conversation lasts 15 minutes.			
22. The same facts as item 21, except the conversation lasted 25 minutes.			
23. A client telephones or e-mails you for some advice. You give the answer, which is helpful to the client. The call or e-mail takes two minutes.			
24. The same facts as item 23, except the call or e-mail takes 10 minutes.			
25. The same facts as item 23, except the call or e-mail takes 20 minutes.			
26. A client telephones or e-mails to arrange an appointment with you. The call or e-mail takes two minutes.			
27. Over a period of two weeks, the same client calls or e-mails four times for advice. Each time, you give a helpful answer to the client. Each call or e-mail takes only a few minutes.			
28. Your normal travel time to your office is 30 minutes. You leave your home 15 minutes early since it takes you 45 minutes to travel to a client's office. You stay there all day. The excess travel time totals 30 minutes.			

(continued)

	<i>Report the Time as:</i>		
	<i>Not Record the Time</i>	<i>Nonchargeable Number of Hours</i>	<i>Chargeable Number of Hours</i>
29. In the morning, you travel to client X. After lunch, you travel to client Y, which takes 30 minutes. Select only one of the following, and indicate how much time you would charge:			
Client X			
Client Y			
Neither			
30. You encounter a sophisticated technical question you previously researched for another client. The original research took three hours. Photocopying this research data for the second client takes five minutes. How much time would you charge the second client?			
31. For a new engagement, you take last year's working papers home to review them at night, which takes you two hours.			
32. The same facts as item 31, except you review the working papers in the office the day before you are to begin work at the client's office.			
33. You have a technical question concerning a client. During lunch, you discuss it with another team member, who gives you the answer, saving you about one hour of research.			
34. You spend 10 hours doing a schedule. Later, you discover you made a major mistake. It takes you three hours to redo the schedule. Indicate how you would charge the three hours of correction time.			

EXHIBIT 9-2: SAMPLE RESULT FROM TIME-KEEPING SURVEY

1. During a regular workday at the client's office, you and the controller go to lunch. The lunch takes one and one-half hours. Most of the discussion is about the client's business.	
Charged one-half hour	13
Charged 3/4 hour	1
Charged one hour	2
Charged more than one hour (i.e., the actual time spent)	3
Charged more than one hour (but less than the actual time spent)	1
2. The same facts as item 1, but the lunch takes one hour.	
Not shown on the time sheet	13
Charged 1/2 hour	2
Charged 3/4 hour	1
Charged one hour	4
3. The same facts as item 1, but the lunch takes two hours.	
Charged one hour	16
Charged more than one hour (i.e., the actual time spent)	3
Charged more than one hour (but less than the actual time spent)	2
4. The president of one of your clients asks you to dinner to discuss an accounting, tax, or business problem. The dinner takes two hours. Most of the discussion is about the client's problem.	
Shown on the time sheet as <i>nonchargeable</i>	1
Not shown anywhere on the time sheet	2
Charged one hour	1
Charged more than one hour (the actual time spent)	12
Charged more than one hour (but less than the actual time spent)	4
5. You are working at a client's office and encounter a technical question, which takes 20 minutes of research to answer.	
Shown on the time sheet as <i>nonchargeable</i>	4
Charged 1/4 hour	11
Charged 1/2 hour	5
6. The same facts as item 5, except that you believe the research involved an area of practice you should have known.	
Shown on the time sheet as <i>nonchargeable</i>	8
Not shown anywhere on the time sheet	3
Charged 1/4 hour	6
Charged 1/2 hour	2
7. The same facts as item 5, except that you believe the research you did would have taken an average person (i.e., one not as knowledgeable as you) one hour to accomplish.	
Shown on the time sheet as <i>nonchargeable</i>	4
Charged 1/4 hour	9
Charged 1/2 hour	6
Charged one hour	1

(continued)

EXHIBIT 9-2: SAMPLE RESULT FROM TIME-KEEPING SURVEY (CONTINUED)

8. The same facts as item 5, except the research took you one hour, you do not feel competent in this type of research, and you believe that it should have taken you about 20 minutes.	
Shown on the time sheet as <i>nonchargeable</i>	4
Not shown anywhere on the time sheet	1
Charged 1/4 hour	5
Charged 1/2 hour	5
Charged one hour	5
9. You are working in the firm's office on client X. A team member interrupts you to ask questions about a problem he or she is having with client Y (for whom you have no responsibility). The interruption lasts 20 minutes. Select only one of the following and indicate how much time you would charge: Client X <u>1</u> , Client Y <u>15</u> , Neither <u>4</u> ?	
Shown on the time sheet as <i>nonchargeable</i>	4
Not shown anywhere on the time sheet	1
Charged 1/4 hour	11
Charged 1/2 hour	4
10. The same facts as item 9, except the interruption lasts 10 minutes. Select only one of the following and indicate how much time you would charge: Client X <u>1</u> , Client Y <u>12</u> , Neither <u>6</u> ?	
Shown on the time sheet as <i>nonchargeable</i>	8
Not shown anywhere on the time sheet	1
Charged 1/4 hour	11
11. During the day, you do not feel well and believe your productivity was less than it should have been as a result of coughing spells, blowing your nose, trips to the bathroom, etc. You have worked on one client for the entire day, and the time lost due to illness was about one hour.	
Shown on the time sheet as <i>nonchargeable</i>	13
Not shown anywhere on the time sheet	2
Charged one hour	5
12. Not asked on survey.	
13. During a typical workday at the client's office, you determine that you made trips to the coffee machine, bathroom, and water cooler, and placed a personal phone call, totaling about 15 minutes of nonclient personal time.	
Shown on the time sheet as <i>nonchargeable</i>	6
Not shown anywhere on the time sheet	2
Charged 1/4 hour	12
14. The same facts as item 13, except you were working in your office all day on <i>one</i> client.	
Shown on the time sheet as <i>nonchargeable</i>	9
Not shown anywhere on the time sheet	3
Charged 1/4 hour	8

15. The same facts as item 13, except you were working in your office all day on several different clients.	
Shown on the time sheet as <i>nonchargeable</i>	12
Not shown anywhere on the time sheet	3
Charged 1/4 hour	5
16. You are under heavy time pressure on an assignment. You do not want to go over budget. So, on one day, you bring some work home and spend one hour completing it.	
Shown on the time sheet as <i>nonchargeable</i>	1
Not shown anywhere on the time sheet	5
Charged 1 hour	14
17. The same facts as item 16, except you take work home on several days, i.e., one hour a day at home.	
Not shown on the time sheet	3
Charged 1/2 hour	1
Charged 1 hour	6
Charged more than one hour (i.e., the actual time spent)	8
Charged more than one hour (but less than the actual time spent)	2
18. The same facts as item 16, except you do enough work in one evening to complete a job due the next day, i.e., several hours.	
Not shown on the time sheet	3
Charged more than one hour (i.e., the actual time spent)	14
Charged more than one hour (but less than the actual time spent)	3
19. While working in your office, another person comes over to talk to you on a nonclient matter. He or she leaves 15 minutes later.	
Shown on the time sheet as <i>nonchargeable</i>	14
Not shown anywhere on the time sheet	5
Charged 1/4 hour	1
20. A client decides to close their office an hour early on Friday. At that point, you have spent seven chargeable hours at the client's office. It's too late to return to the firm's office, so, you go home, where you work for one hour to finish the day.	
Shown on the time sheet as <i>nonchargeable</i>	6
Not shown anywhere on the time sheet	10
Charged one hour	3
One person would charge time needed to drive home.	
21. During the day at a client's office, a client's employee gets into a 15-minute conversation about a nonclient matter (i.e., a personal problem or sports). The conversation lasts 15 minutes.	
Shown on the time sheet as <i>nonchargeable</i>	2
Not shown anywhere on the time sheet	2
Charged 1/4 hour	16

(continued)

EXHIBIT 9-2: SAMPLE RESULT FROM TIME-KEEPING SURVEY (CONTINUED)

22. The same facts as item 21, except the conversation lasted 25 minutes.	
Shown on the time sheet as <i>nonchargeable</i>	2
Not shown anywhere on the time sheet	3
Charged 1/4 hour	2
Charged 1/2 hour	13
23. A client telephones or e-mails you for some advice. You give the answer, which is helpful to the client. The call or e-mail takes two minutes.	
Shown on the time sheet as <i>nonchargeable</i>	8
Not shown anywhere on the time sheet	4
Charged 1/4 hour	2
Charged 1/2 hour	1
Four persons would charge 1/10 hour.	
24. Not asked on survey.	
25. Not asked on survey.	
26. A client telephones or e-mails to arrange an appointment with you. The call or e-mail takes two minutes.	
Shown on the time sheet as <i>nonchargeable</i>	12
Not shown anywhere on the time sheet	6
Charged 1/4 hour	2
27. Over a period of two weeks, the same client calls or e-mails four times for advice. Each time, you give a helpful answer. Each call or e-mail takes only a few minutes.	
Shown on the time sheet as <i>nonchargeable</i>	4
Not shown anywhere on the time sheet	1
Charged 1/4 hour	10
Charged 1/2 hour	1
Three persons would charge 1/10 hour.	
28. Your normal travel time to your office is 30 minutes. You leave your home 15 minutes early since it takes 45 minutes to travel to a client's office. You stay there all day. The excess travel time totals 30 minutes.	
Shown on the time sheet as <i>nonchargeable</i>	2
Not shown anywhere on the time sheet	4
Charged 1/4 hour	2
Charged 1/2 hour	12
Charged 3/4 hour	1
29. In the morning, you travel to client X. After lunch, you travel to client Y, which takes 30 minutes. Select only one of the following, and indicate how much time you would charge. Client X <u>3</u> , Client Y <u>11</u> , Neither <u>1</u> ?	
Six would split it between the two clients, charging 1/4 hour to each.	
Shown on the time sheet as <i>nonchargeable</i>	1
Not shown anywhere on the time sheet	3
Charged 1/4 hour	16

30. You encounter a sophisticated technical question you previously researched for another client. The original research took three hours. Photocopying this research data for the second client takes five minutes. How much time would you charge the second client?	
Not shown on the time sheet	1
Charged 1/4 hour	8
Charged 1/2 hour	2
Charged one hour	3
Charged more than one hour (i.e., the actual time spent)	6
31. For a new engagement, you take last year's working papers home to review them at night, which takes you two hours.	
Shown on the time sheet as <i>nonchargeable</i>	5
Not shown anywhere on the time sheet	2
Charged one hour	2
Charged more than one hour (the actual time spent)	11
Charge more than one hour (but less than the actual time spent)	1
32. Not asked on survey.	
33. You have a technical question concerning a client. During lunch, you discuss it with another team member who gives you the answer, saving you about one hour of research.	
Shown on the time sheet as <i>nonchargeable</i>	2
Not shown anywhere on the time sheet	15
Charge one hour	3
34. You spend 10 hours doing a schedule. Later, you discover you made a major mistake. It takes you three hours to redo the schedule. Indicate how you would charge the three hours of correction time.	
Shown on the time sheet as <i>nonchargeable</i>	7
Not shown anywhere on the time sheet	3
Charged one hour	1
Charge more than one hour (i.e., the actual time spent)	7
Charge more than one hour (but less than the actual time spent)	2



CHAPTER 10

GET IT IN WRITING

You should view yourself as providing financial services to clients, not financing their businesses. You need to ensure that clients understand what you intend to do, what you are not going to do (with special emphasis on items you did last time that you now want the client to do, or items included in the price last time that are not included now), how you will determine the price, and when the client will pay.

One of the best ways to make certain that clients are clear on these issues is to put it in writing. This chapter will discuss engagement letters, change orders, invoices, and termination letters.



ENGAGEMENT LETTERS

Commonly, one engagement letter covers all accounting, auditing, and regular tax services to be provided during a year-long period. This way, you don't have to issue separate letters for recurring services, such as monthly compilations or quarterly estimated tax returns. The AICPA's *MAP Handbook* advises separate letters for management consultant services (MCS) services, unusual tax matters (such as a tax audit), and other special engagements. The Handbook also suggests the following matters generally are addressed in an engagement letter:¹

- *Addressee.* Address the engagement letter to the individual or group who retains your firm. This may be the board of directors or an audit committee, in which case you may address the letter to the chairman of the board or committee. If you arranged the engagement with an officer, you may address the letter to him or her, by name and title.

KEY POINT: For closely held businesses, you may address the engagement letter to the owner individually and say in the scope paragraph, "... services which we are to perform for Any Company, Inc." This may be particularly helpful if you have to call on the owner to make good on his or her personal guarantee to pay the corporation's liability to you. Consult your attorney for appropriate wording.

- *Entity.* Include the subsidiaries, divisions, etc., if applicable, that are covered by the engagement.
- *Financial statements.* Include all statements to be compiled, reviewed, or audited, and the period covered by such statements.

¹ Adapted from "Client Engagements," Chapter 204 of the *Management of an Accounting Practice Handbook*. New York: American Institute of Certified Public Accountants, 1996, Chapter 204, pages 21-22.

- *Tax returns.* Specify the returns to be prepared by form name and number.
- *Services to be provided.* Clearly describe the nature of the service or services to be performed in as much detail as necessary. Examples are accounting, tax, or MCS.
- *Scope.* A description of the scope of the engagement should include any limitations imposed or special procedures requested by the client.
- *Special conditions.* When appropriate, the letter may mention special aspects of the engagement, such as the use of a specialist or other auditor.
- *Excluded services.* Services excluded from the engagement should be specified. Language should be nontechnical and distinguish between separate services if a mix of services is being provided.
- *Limitations of the service.* Describe the inherent limitations of an audit, review, or compilation or engagements involving prospective financial information. For services not involving financial statements, indicate that they do not constitute an audit.
- *Limitations on the use and distribution of your work product.* Identify direct and indirect users—for example, by specifying that it is for the client's internal use only.
- *Type of report.* Mention the type of report that is expected to be issued, and indicate whether you anticipate that your opinion will be qualified for any reason. For new clients, you could include the anticipated wording of a compilation or review report so they won't be surprised or disappointed at the final report. Describe the general content of the expected report on an MCS engagement. The letter may indicate who the report will be addressed to and the number of copies you will provide. Mention other reports you may issue, such as a report on material control weaknesses or a management letter addressing reportable conditions.
- *Client reproduction of the report.* If you believe the client may reproduce the report in other printed material, the letter may provide that your approval is required for such reproduction.
- *Client responsibility for statements.* Explain that the client has the primary responsibility for the financial statements that your firm compiles, reviews, or audits. The statements are the responsibility of the client, even though the accountant may help maintain accounting records, suggest appropriate accounting principles, or prepare the client's financial statements. The engagement letter may mention that you will request written representations of management. Again, you don't want the client to have any unpleasant surprises.

KEY POINT: Client assistance—In the engagement letter, specify the assistance you expect the client to provide, such as preparing schedules and analyses, typing confirmations, and locating documents, including a timetable indicating when the client-prepared schedules will be needed.

When I was an audit partner, I always included a detailed list of the expected schedules as an exhibit to the letter. I also included a timetable of when the firm would need the client-prepared schedules.

- *Withdrawal.* Identify the situations in which you might withdraw from an engagement. This may help avoid a claim for breach of contract. Effective provisions allow for the withdrawal if fees are not paid or if you believe that a potential breach of professional standards may occur unless you withdraw.
- *Timing.* Indicate when you will begin and complete the engagement. Indicate when you will deliver reports or tax returns. Cover the extent and timing of any interim work.
- *Invoicing procedures.* Include an estimate of the price or range of prices, allocated among the various services to be performed (for instance, audit and tax), if possible. Also cover the method you will use to determine prices, the frequency of invoicing, the treatment of collection costs and attorney's fees, interest on past-due balances, your right to suspend work in progress until unpaid balances are cleared, and any required deposit. Include the wording that the estimate is being based on the assumption that the client will provide assistance and that unforeseen developments may affect the price. The letter for a new engagement might discuss any arrangement you have made for startup costs. Some CPAs routinely volunteer to absorb startup costs even though clients have not broached the subject. This is lost income, because many clients expect to pay for startup costs.
- *Mediation.* Include a mediation provision in your engagement letter, specifying that the client agrees to submit any engagement-related differences to mediation before resorting to litigation.
- *Site of engagement.* If you and the client are located in different states, agreeing in advance on the site of the engagement gives you the valuable choice of law and courts should there be engagement-related litigation.
- *Designated representative.* During the engagement, you will rely on the representations of the client. Have the client designate one person at the beginning of the engagement to serve as the client's spokesperson. This avoids different and often conflicting decisions by various members of management.
- *Approval.* Obtain the client's written acknowledgment of the terms of the engagement. A less desirable alternative is to ask for a response only if the client does not understand or agree with any of the terms. In any event, if the nature or scope of the engagement changes from preceding years, take this opportunity to initiate the use of an engagement letter approved by the client.

Let's put all these recommendations together, as shown in Exhibit 10-1, "Sample Fixed-Price Agreement Letter." This sample is based on providing a high level of monthly consulting to the client, in addition to the normal accounting and tax services. For a compliance client only, you could omit the paragraphs noted as optional. Note, in the letter, this agreement can be termed a *suggested arrangement* because of the satisfaction guarantee and the discretion of the client to pay more or less than the recommended price.

Include Payment Terms in the Engagement Letter

Providing for payment "upon presentation" or "when invoices are rendered" is not realistic for most clients and may cause them to not take your payment terms seriously. The following examples will achieve your actual collection goals, and most clients will be able to accommodate these terms. Your attorney should review any language regarding interest, late charges, collection costs, and so forth for compliance with your local laws.

Example:

Invoices will be rendered every two weeks and are payable within 10 days of invoice date.

Example:

All invoices are due and payable within 30 days.

Example:

Our policy is to invoice every two weeks for services and costs. Payment is due by the end of the month in which invoices are rendered.

Example:

We will invoice you monthly. Our invoices are payable within 15 days. Amounts outstanding at the end of the month will bear interest at ____ percent per annum. Further, we will not commence additional services if any balance is delinquent. You agree to pay any reasonable attorney fees and collection costs incurred by us in connection with your balance.

Example:

Our firm policy requires a retainer of \$ _____ , to be applied against the final invoice.

Example:

Invoices to the corporation are personally guaranteed by [owner-manager]. [Author's Note: In this case, the engagement letter should be signed by the owner-manager personally, in addition to his or her signature as corporate officer. Your attorney should suggest specific language.]

Example:

Your returns, of course, are subject to review by the taxing authorities. [Or, "The outcome of any litigation is subject to review or reversal by a higher court."] Any items resolved against you by the examining agent are subject to certain rights of appeal. [Or, "Any damages awarded ... ," or "Any zoning permits obtained ... ," and so forth.] In the event of an examination [Or, "Appeal," and so on], we will be available upon request to represent you and will charge you for these additional services.

Allow for Value Pricing in Your Engagement Letters

“Unfortunately, many firms’ standard engagement letter terms do not allow for charging above standard rates, even if justified. Instead, such letters include a provision such as, ‘Our prices are based on the time we devote to an engagement.’”² Or, ‘Our price for these services will be at our regular per diem rates, plus travel and other out-of-pocket costs.’ Or,

Price Estimate and Timetable—We estimate that our price for this project will range from \$40,000 to \$44,000. Our policy is to invoice every two weeks for services and costs. Payment is due when invoices are rendered. We will keep you informed of our progress during the engagement. If time actually spent is less than our estimate, you will be invoiced for the lesser amount. If we encounter extraordinary problems that could increase the quoted price, we will inform you....

Exhibit 10-2, “Sample Value Pricing Language for Engagement Letters,” gives illustrative language that allows you to value price when appropriate.



CHANGE ORDER

If any unanticipated services arise that are not specified in the suggested arrangement letter, prepare a change order for the client’s approval. See Exhibit 10-3, “Sample Change Order,” and Exhibit 10-4, “Sample Change Order for Scope Change.” Most change letters follow the form of Exhibit 10-3. Exhibit 10-4 gives the part that is different.



USE THE INVOICE TO SELL THE SERVICE

I have reviewed thousands of invoices sent by perhaps a hundred or more accounting firms over the years. The following sections describe the characteristics of the better billers in terms of appearance, language, detail, and the handling of higher-than-expected bills.

Appearance of the Invoice

There are ways to make your invoice easier to read:

- Type all invoices using Times Roman 12 point type.

Here is an example of 12 point type.

- Do not use initial capitals.

Initial Caps May Be Appropriate For Major Groups of Accounts on Financial Statements, But—As You Can See From Reading This Sentence—They Are A Bit Much For The Text Of Invoices.

² Cottle, David, *Professional’s Guide to Target Marketing: How to Gain Profitable New Business*. San Diego. Harcourt Professional Publishing, 2000, page 239.

- Courier typefaces, such as the one shown in the following sample) are old-fashioned:

Nobody uses typewriters any more, and you don't want your invoices to look like you do.

- Dot-matrix printers are even worse. No CPA should still be using these antiques. If you are, get a modern printer immediately.
- All capital letters are more difficult for people to read, as the following sample shows:

THEY USED TO BE COMMON IN FIRST GENERATION COMPUTER PROGRAMS THAT COULD NOT GENERATE LOWER CASE LETTERS, BUT THEY SHOULD NOT BE USED ANY MORE BECAUSE OF THEY DISTRACT THE READER.

- Do not use sans serif fonts, such as the following sample; they are too hard to read:

Moreover, don't use sans serif fonts like Arial (the font used in this paragraph), Helvetica, or Swiss for anything but captions or headlines. If you give out two sets of data, one in sans serif type and one in Roman type, and then test the two groups of readers for their comprehension of the data, the group who read the Roman type will have comprehended over 25 percent more.

- All invoices should be on letterhead, not printer paper. You want to be perceived as a first-class firm. Use first-class paper and envelopes.

Language of Invoices

Use the right words to describe what you did. Follow these suggestions:

- Use *telephone consultation and followup* in preference to *telephone call*, if the telephone call involved a followup.
- Similarly, use *consultation* instead of *discussion*.
- Use *conference* instead of *meeting*.
- Use the word *research* whenever possible. This communicates the value of your services to the client.

Details of Invoices

Generally, the more detailed explanation you give clients, the better, especially regarding any potential savings or profits you have helped the client to achieve. As one California CPA put it:

KEY POINT: The more you write, the more you can charge.

- Describe any item that significantly increased the price over the prior period.

Example: Any of the following can be used to describe the various federal, state, and local individual income tax returns prepared:

- “...including reworking tax return for changes by client”
- “...including accounting for commodity transactions”
- “...including the calculation of basis from inheritance and accounting for equipment and cattle purchases and sales”
- “...including research on deductibility of IRA”
- “...including correspondence during 20XX with Department of Revenue of West Virginia and preparation of tax projection regarding timber sale and related work”

- Describe any item that caused a higher price than the client expects.

Example: Describe various accounting services rendered for the month of July 20XX, by writing, “...including analysis of business transactions through July 20XX .”

- Give detailed explanations of services rendered on invoices, but give only one amount due. This makes the nature of your services more visible to the client. Here is an example of one such invoice sent by one of my clients.

Example: For professional services rendered through April 30, 20XX:

Analysis of accounting records for tax purposes

Preparation of the following payroll tax returns for the quarter ended March 31, 20XX:

- Form 941 Employers Quarterly Federal Tax Return
- Form XXX State Employment Security Quarterly Report
- Form XX Employers Return of State Income Tax Report

Accounting services for the month of March, 20XX:

- Reconciliation of checking account
- Preparation of cash receipts and cash disbursements journal
- Preparation of check register
- Posting of transactions to general ledger
- Preparation of detailed general ledger
- Preparation of compiled financial statements including:
 - Balance sheet as of March 31, 20XX
 - Income statement for the month of March 20XX and for the three months ended March 31, 20XX, with comparative figures for 20XX
 - Statement of cash flow for the month of March 20XX and for the three months ended March 31, 20XX, with comparative figures for 20XX
- Preparation of payroll checks

AMOUNT DUE	<u>\$2,985.00</u>
------------	-------------------

EXCEPTION: If you have done extra work on a fixed-price engagement, or for a monthly-retainer client, show the fixed price or regular work as one amount, and list the extra work below with one amount for all extra work.

Example:

Regular accounting work for the month of July	\$ 900.00
Extra work:	
Accounting for sale of Beaver Street rental property	
Accounting for sale of [<i>description</i>] under new capital gains rules	
Preparation of [<i>description of various tax returns</i>]	
Total extra work	<u>950.00</u>
Balance due	<u>\$1,850.00</u>

- Also, you can add a single line item for any *reimbursable expenses* such as messenger service, overnight shipping, travel, the printing of extra copies of reports, and so forth. Reimbursable expenses should be an exact amount and should be in agreement with your work in progress (WIP) run to the penny, in case a client ever asks to see backup.

CAUTION: Never invoice for a reimbursable expense of less than \$20 or so. Clients hate to be “nickle-and-dimed.”

- Generally, do not invoice amounts less than \$100. It causes clients to conclude that you deal in trivia.
- List any state income tax returns and all estimated returns as separate line items.

Example: The following is a list of returns prepared:

- Preparation of Form 1040, 20XX, U.S. Individual Income Tax Return for John and Mary Smith
- Preparation of Form 1040ES, 20XY, U.S. Declaration of Estimated Income Tax for John and Mary Smith
- Preparation of Form XXX, 20XX, Pennsylvania Resident Personal Income Tax Return for John and Mary Smith
- Preparation of Form XXX, 20XY, Pennsylvania Declaration of Estimated Income Tax for John and Mary Smith
- Preparation of Form XXX, 20XX, Ohio Nonresident Individual Income Tax Return for John and Mary Smith
- Preparation of Form XXX, Pennsylvania 20XY, Intangible Tax Return
- Consultation regarding 20XX Metropolis County property tax assessment and review of proposed assessment

- Consider listing each tax schedule and form number included with the returns. One of my clients provides detailed explanations like these for very expensive individual income tax returns.

Example: The following lists very expensive returns:

Form 1040 U.S. Individual Income Tax Return

Schedule A, Itemized Deductions. This schedule reports deductions allowed for medical expenses, taxes, interest, contributions, and other miscellaneous deductions.

Schedule B, Income from Interest and Dividends. This schedule reports interest and dividend income.

Schedule C, Profit or Loss From Business. This schedule reports results of your business activity. The second schedule C reports income from working interests in oil and gas.

Schedule D, Capital Gains and Losses. This schedule reports gains and losses from the sale of investments and gains and losses passed through to you reported on Forms K-1 and from Forms 1099-B reported from brokerage firms.

Schedule E, Supplemental Income and Loss. This schedule reports income from rental activities that otherwise are not formal partnerships or S corporations. This schedule also reports income from royalties.

Schedule E, page 2, Supplemental Income and Loss. This schedule reports net allowable losses and income from K-1 activities and includes all partnerships and S corporations.

Form 4562, Depreciation and Amortization. This schedule reports allowable deductions for depreciation that end up being deducted from either Schedule C or Schedule E.

Form 4797, Sale of Business Property. This schedule reports gains from Forms K-1 having to do with dispositions of property within those entities.

Form 4835, Farm Rental Income and Expenses. This form reports both the Nowhere County farm and the Somewhere County farm operations.

Form 4952, Investment Interest Expense Deduction. This form calculates deductible interest expense.

Form 6251, Alternative Minimum Tax. This form calculates the tax due under the alternative minimum tax rules and compares the amount of tax calculated under the normal tax rate calculations.

Form 8271, Investor Reporting of Tax Shelter Registration Number. This form is required if one invests in a registered tax shelter. The XYZ National Syndicated Residential Fund is the partnership that requires this form.

Form 8582, Passive Activity Loss Limitations. These forms are required to be calculated in two ways. The first computes allowable losses that can be deducted or suspended for regular tax purposes. The second calculates amounts deductible for purposes of the alternative minimum tax calculations.

1040ES, Estimated Tax Vouchers for 20XX. These forms are used to prepay your 20XX tax. They were prepared using the safe harbor method.

ST Form SS, State Individual Income Tax return.

ST Form SS-ES, State Estimated Tax Vouchers for 20XX.

- Also detail any data preparation or sorting you had to do because the client did not give you their information in good order.

Handling a Higher-Than-Expected Invoice

Fortunately, the way clients react to bad news mostly depends on how you tell them. Do not turn off clients by telling them *no* or giving them bad news without preamble.

For example, if your invoice is more than you expected, do not start with, "This is going to cost you more than I thought." Instead, begin by explaining the facts on which you and the client based the original estimate, then show how those assumptions were in error (through no fault of yours, it is hoped), and the effect that this will have on your price estimate. Remind the client that your original estimate was only an estimate, and get his or her agreement to the modification of your price before you proceed.

Remember the expression, "Play the offense, not the defense?" As soon as you know or can anticipate a problem, take the initiative and call the client. Do not wait for the client to call you.



CLIENT TERMINATION LETTER

If clients are not paying you, they are not clients. You have no ethical obligation to work without pay. In fact, it is unfair to your other clients. See Exhibit 10-5, "Sample Client Termination Letter for Nonpayment of Account."

EXHIBIT 10-1: SAMPLE FIXED-PRICE AGREEMENT LETTER

[Date]

[Addressee]

Dear Anne:

I am delighted to send you this suggested arrangement for an Annual Services Arrangement with Any Corporation, Inc. (you), effective January 1, 200Y. This letter confirms our understanding as to the scope of the work that we will perform for you.

[The following clause is optional.] To improve communication between us, this letter clarifies the Gold Medal services we intend to perform for you (as described in the attached brochure) as well as your responsibilities under this arrangement.

200X Professional Services

We will perform the following services for you during 200Y:

<i>Service</i>	<i>Suggested Price</i>
<input type="checkbox"/> Prepare approximately 85 Forms W-2, <i>Wage and Tax Statements</i> , for 200X	\$ XXX
<input type="checkbox"/> Prepare your Form W-3, <i>Transmittal of Wage and Tax Statements</i>	XXX
<input type="checkbox"/> Prepare approximately 126 Forms 1099MISC, <i>Miscellaneous Income</i> , for 200X	XXX
<input type="checkbox"/> [Include the state forms comparable to the above federal forms.]	XXX
<input type="checkbox"/> Prepare your Form 1096, <i>Annual Summary and Transmittal of U.S. Information Returns</i> , for 200X	XXX
<input type="checkbox"/> Prepare your Form 941, <i>Employer's Quarterly Federal Tax Return</i> , for the period ended December 31, 200X	XXX
<input type="checkbox"/> Prepare your Form ABC, <i>State of Columbia Employer's Quarterly Tax Return</i> , for the period ended December 31, 200X	XXX
<input type="checkbox"/> Prepare your Form XYZ, <i>State of Columbia Sales and Use Tax Return</i> , for the period ended December 31, 200X	XXX
<input type="checkbox"/> Prepare your Form 940, <i>Employer's Annual Federal Unemployment (FUTA) Tax Return</i> , for 200X	XXX
<input type="checkbox"/> Prepare your Form DEF, <i>Workers' Compensation Report</i> , for the period ended December 31, 200X	XXX
<input type="checkbox"/> Prepare your Forms 941, <i>Employer's Quarterly Federal Tax Returns</i> , for the periods ended March 31, June 30, and September 30, 200Y	XXX
<input type="checkbox"/> Prepare your Forms ABC, <i>State of Columbia Employer's Quarterly Tax Returns</i> , for the periods ended March 31, June 30, and September 30, 200Y	XXX
<input type="checkbox"/> Prepare your Form XYZ, <i>State of Columbia Sales and Use Tax Returns</i> , for the periods ended March 31, June 30, and September 30, 200Y	XXX
<input type="checkbox"/> Prepare your Forms DEF, <i>Workers' Compensation Reports</i> , for the periods ended March 31, June 30, and September 30, 200Y	XXX
<input type="checkbox"/> 200X year-end accounting adjustments and closing of 200X books	XXX
<input type="checkbox"/> Prepare approximately 7 Schedules K-1 (Form 1120S), <i>Shareholder's Share of Income, Credits, Deductions, etc.</i> , for 200X	XXX

(continued)

<i>Service</i>	<i>Suggested Price</i>
<input type="checkbox"/> Prepare any bookkeeping entries we find necessary in connection with preparation of the income tax returns	N/C
<input type="checkbox"/> Prepare your Form 1120S, <i>U.S. Income Tax Return of an S Corporation</i> , for 200X	XXX
<input type="checkbox"/> Compile your financial statements for 200X, with your personnel to provide the schedules and analyses attached as Exhibit A by March 3, 200Y	XXX
<input type="checkbox"/> Annual consulting service for 200Y*	XXX
Total Professional Services for 200Y	<u>XX,XXX</u>

* Included in the annual consulting service are the following services we will provide you:

- Unlimited meetings to discuss the operations of Any Corporation, business matters, tax matters, and any other topic, at the discretion of Any Corporation or its employees and/or agents
- Unlimited telephone support for your personnel and/or your independent contractors and agents regarding accounting assistance, the recording of transactions, etc.

[*This heading is optional.*] Recommended Price and Expenses

[*The following clause is optional.*] Our price for this project will be at your discretion with a recommended minimum payment of \$XXX per month for the first year.

Because our arrangement provides ongoing access to the business advice you need, you are not inhibited from seeking timely advice for fear of “the clock running.” Our services are designed around value pricing, as opposed to cost-plus rates, and offer you access to our accumulated experience to help enhance your company’s future and achieve its business goals.

As described in the attached brochure, this arrangement entitles you to unlimited consultation with us on operational issues relating to properly recording, classifying, or handling your business transactions. If your question or issue requires additional research and analysis beyond the consultation, that work will be subject to an additional price negotiation before the service is to be performed, and a Change Order will be issued before delivery of the additional service, with payment terms agreed to in advance.

Unanticipated Services

If an unanticipated need arises (such as, but not limited to, an audit by a taxing agency, or any other service not covered in this agreement by the parties), we agree to perform this additional work at a price mutually agreed upon before the service is provided. This service will be invoiced separately to you as part of a Change Order and will be payable upon presentation [*or, payable according to the terms mutually agreed upon*].

[*This heading is optional.*] Service Guarantee

[*The following clause is optional.*] As described in the attached brochure, we guarantee our work to your complete satisfaction. If you are not completely satisfied with our services, we will, at your option, either refund the price, or accept a portion of said price that reflects your level of satisfaction. We will assume you are satisfied upon payment received each month under the terms of this arrangement.

[*The following clause is optional.*] To assure that our arrangement remains responsive to your needs, as well as fair to both parties, we will discuss the monthly payment at any time throughout the year

and, if necessary, revise or adjust the scope of services provided and the prices charged in light of mutual experience.

[*The following clause is optional.*] Our goal is 100-percent client satisfaction. This arrangement mentions “recommended fee” for a reason. If, for any reason, you feel that any month’s payment, when considered in conjunction with our entire relationship, is inappropriate, we want you to feel free to call to discuss a more appropriate amount, or, you may simply adjust the following month’s payment for whatever you believe the service was worth.

[*The following clause is optional.*] Since you are paying a nonrefundable (after one month) payment each month, your risk is limited to \$XXX.

[*The following clause is optional.*] If you wish to pay extra for any month, please consider your best estimate of the value we have brought to your company through this arrangement, but it is also acceptable to wait until the year-end to determine how much extra value we have brought to your company, if any.

[*The following clause is optional.*] We will communicate with you often, making recommendations to help you build a better business and building a win-win and long-term relationship with you. We naturally expect you to communicate frequently with us, too.

In return for our commitment to your satisfaction, after we have worked with your for three months and you have a good perspective on what we can do for your business, we ask you to give consideration to referring to us at least one other business whom you believe would benefit from an association with us.

Quality Review

You agree, and hereby consent, to participate in our policy of internal Quality Review. We subscribe to a policy of quality review to maintain the highest quality of service from our firm. As part of this program, all major services performed under this Agreement may be reviewed by another CPA within our firm under strict rules of confidentiality. The price for this review is included in the above professional services.

The “Fine Print”

Either party may terminate this arrangement at any time, for any reason, with 10 days of written notice to the other party. If you are not completely satisfied with our services, we will, at your option, either refund the current month’s payment, or refund a portion of the retainer that reflects your level of satisfaction.

[*The following clause is optional.*] You acknowledge that the proprietary information, documents, materials, management techniques, and other intellectual property we use are a material source of the services we perform and that these were developed prior to our association with you. Any new forms, documents, or intellectual property we develop in this engagement for your use shall belong to us, and you shall have the limited right to use them solely within your business. All reports, manuals, forms, checklists, questionnaires, letters, agreements (including this one), and other documents, which we make available to you are confidential and proprietary to us. Any and all new documents created as a result of this arrangement will automatically become our property. Neither you nor any of your agents will copy or electronically store, nor reproduce nor make available to anyone other than your personnel, any such documents.

[*The following clause is optional.*] We agree to keep your proprietary information confidential.

[*The following clause is optional.*] We will base our business recommendations primarily on the data you furnish. We will not audit or otherwise verify data you submit. Although we believe our recommendations will be sound, the degree of success with which you apply our recommendations depends on factors beyond our control, including, but not limited to, the actions of your

personnel, customers, competitors, regulators, and the condition of the economy (and naturally this list is not intended to be exhaustive). Managing your business requires careful attention since it determines the success and profit of your business. Therefore, subject to the following paragraph, you agree that our liability for damages, regardless of the form of action, shall not exceed the total amount paid for services under this arrangement for the most recent month. You further agree, subject to the following paragraph, that we are not liable for any lost profits, or for any claim or demand against you by any other party and you agree to hold harmless and indemnify us, including reasonable attorneys' fees and costs, against any and all claims made as a result of our properly authorized actions performed under, and/or related to, this Agreement. Neither party can bring an action, regardless of form, arising out of the services under this Agreement more than one year after the party knew or should have known that it had the right to pursue the cause of action. We do not make any express or implied warranties, including, but not limited to, the implied warranties of merchantability and fitness for a particular purpose. Subject to the following paragraph, we will not be liable for consequential damages even if we have been advised of the possibility of such damages.

Notwithstanding anything to the contrary set forth in the preceding paragraph, our liability to you for damages incurred by you and actions or claims brought against you shall not be limited if such damages, actions, or claims are attributable to our gross negligence, our unauthorized acts, our willful misconduct, our libel and/or slander, or our unlawful conduct. In addition, you shall not indemnify and hold us harmless for any claims or actions against us resulting from our negligence or our unlawful conduct.

To confirm the arrangement, please return a signed copy of this agreement with your check for \$XXX for the payment for January 200Y. Each month's payment is payable in advance on the first of each month. If you like, we can arrange to charge each retainer to a major credit card or we can invoice you. Just let us know which you prefer.

We look forward to providing you with the highest level of service possible in the upcoming year!

Very truly yours,

[*CPA firm*]

By:

Agreed to and authorized:

By:

Date:

Client:

EXHIBIT 10-2: SAMPLE VALUE PRICING LANGUAGE FOR ENGAGEMENT LETTERS³

We generally base our prices on the time required at our regular rates for the services and personnel assigned plus out-of-pocket costs and relevant computer charges. [*Author's Note: The use of the word generally allows for exceptions.*] However, our charges also may include other appropriate factors, including the difficulty of the assignment, the degree of risk and responsibility the work entails, time limitations imposed on us by others, the experience and professional expertise of the personnel assigned, and the priority and importance of the work to the client.

Assuming adequate records, internal controls, and assistance of your personnel, we estimate that our price for the [services] could range as high as \$_____. [*Author's Note: Quote only the top end of the range. If you quote the lower end of the range, that is what the client will remember.*] We will attempt to minimize our fees without sacrificing the quality of our work. The extent to which we can depends on the availability of your personnel to offer us clerical and other assistance to prepare schedules, perform analyses, and provide source documents. If we encounter significant unusual circumstances not contemplated in preparing the estimate, we will discuss them with you and arrive at a new price estimate before we incur additional costs. [*Author's Note: Accountants often omit these contingencies from engagement letters. But this omission makes it easy for the client's personnel to avoid helping the accountant.*]

We have based the estimated price on the assumption that you continue to employ competent, experienced bookkeeping and accounting personnel. If a change in your personnel requires us to spend extra time to train your people or otherwise perform our services, we will invoice you for such extra time. [*Author's Note: You might use this language for a client who has had high turnover in their accounting department.*]

³ Adapted with permission of Aspen Publishers, 2000, David W. Cottle, *Professional's Guide to Target Marketing: How to Gain Profitable New Business*, "How to Discuss Prices," page 239, www.aspenpublisher.com.

EXHIBIT 10-3: SAMPLE CHANGE ORDER

Client: Any Company Inc.

Date: November 10, 20XX

Project Description: [CPA firm] will represent Any Company Inc. before the Internal Revenue Service (IRS) for the audit of their 20XX U. S. Corporation Income Tax Return, Form 1120, for the issues as described in the IRS letter dated November 1, 20XX.

Any Company Inc. hereby agrees that its accounting department will provide all records, documentation, and schedules deemed necessary by [CPA firm].

Price and Terms: Based upon our knowledge of the IRS's concerns and issues to be examined, we hereby agree to represent Any Company Inc. for the fixed price of \$_____, payable 50 percent upon approval of this project and 50 percent upon completion of the audit.

If, in the course of the audit, the IRS raises other issues outside the scope of the IRS letter mentioned above, we and you will enter into another Change Order at that time, at a mutually-agreed upon price.

If you agree with the above Project Description and the price, please authorize and date this Change Order below. A copy is enclosed for your records.

Thank you for letting us serve you.

Very truly yours.

[CPA firm]

By:

Agreed to and authorized:

By:

Date:

Client:

EXHIBIT 10-4: SAMPLE CHANGE ORDER FOR SCOPE CHANGE

Client: Any Company Inc.

Date: August 20, 20XX

Project Description: During fieldwork of the audit for the year ended December 31, 20XX, we discovered that the Prepared By Client (PBC) Schedules listed in Exhibit A to the Engagement Letter were not accurately completed, in a timely manner, by your accounting staff.

To complete the audit in a timely manner, both parties agree that we will now complete the PBC Schedules, a service we did not originally anticipate in our price for the audit. Both parties agree that the price for this service is \$_____, payable upon authorization of this Change Order.

**EXHIBIT 10-5: SAMPLE CLIENT TERMINATION LETTER FOR
NONPAYMENT OF ACCOUNT**

We have received no response from you to our repeated requests for payment of our invoices to you (copies attached) of \$_____. Our policy is to discontinue service to any client whose account remains unpaid more than 30 days. Consequently, we must inform you of our decision to discontinue services. We would like to continue our relationship with you, but we must be paid for our services.

We have discontinued all services we are currently providing you as of this date, and we can accept no further engagements. [*The following clause is optional.*] We have requested our legal counsel to initiate legal action to collect our invoices.

We hope you will send your check today so we can again serve you in the future. [*The following clause is optional.*] We are returning your documents which were in our possession.

GLOSSARY

adjustment, fee—See *write-down* and *write-up*.

allowances, fee—See *write-down* and *write-up*.

allowance for doubtful accounts and billing adjustments—A provision for standard fees that may not be invoiced (*write-downs*) or that may be invoiced and not collected (similar to the adjustment made for bad debts of a commercial client). Bad debts are for inactive clients. For active clients, refer to *billing adjustment* or *write-down*.

billable hour—See *chargeable hours*.

billed accounts receivable—See *receivables, invoiced*.

billing adjustment—See *write-down* and *write-up*.

billing rate—See *chargeout rate*.

CFP—certified financial planner.

chargeout rate—The amount per hour charged to work in process for a service. See also, *effective chargeout rate* and *standard chargeout rate*.

chargeable time—Any time spent that can be identified with serving a specific client. Some professionals distinguish between *billable time* and *chargeable time* based on whether they take a *write-down* (defined below) or *billing adjustment*. In order to have a common vocabulary, in this book, *chargeable time* is all time that is identifiable with serving a particular client regardless of whether there was ultimately a write-down on the account.

client expenses—See *direct client expenses*.

costs recoverable from clients—See *direct client expenses*.

deliverable—Professional services usually provide some tangible evidence of the services, such as a document, a tax return, a tax opinion letter, a written financial plan, or a financial report. Some accountants referred to these tangible representations as *deliverables*. Nevertheless, the service itself is intangible.

direct client expenses—Expenses incurred that are charged directly to the client's *work in progress* and covered in client billing. These include travel, supplies, reproduction costs, postage, telephone, outside services and consultation, and other expenses and do not appear on the firm's income statement either as revenue or expense. Also called *costs recoverable from clients* and *reimbursable costs*.

direct expenses—Personnel compensation and direct client expenses.

direct personnel—Owners and technical staff but not support personnel.

effective billing rate—See *effective chargeout rate*.

effective chargeout rate—Net sales divided by chargeable hours (for a person, department, office, or firm).

engagement letter—A letter written by the CPA firm to the client documenting the mutual understanding and agreement about the nature and terms of the engagement and the degree of responsibility the firm will assume in the providing the subject services. Sometimes referred to as *arrangement letter*, *terms of reference*, *terms of engagement*, or *engagement contract*. The letter may cover other items such as price (or method of determining price), payment terms, type of report to be issued, how the report may be used, limitations on the scope of the engagement, assumptions on which the engagement is based, and assistance the client will provide. In some professions, engagement letters are not a professional requirement, but they are usually a matter of good business practice.

fieldwork—Engagement work done outside the firm's office, often at the client's location.

firm administrator—The most senior-level executive on the support team, responsible for office administration and supervision of the support personnel. In some firms, the firm administrator is also responsible for the firm's management information system and other duties. Also called *office manager* or *business manager*.

FTE—Full-time equivalent.

GAAP—Generally accepted accounting principles.

gross fees—See *standard fees*.

indirect expenses—See *overhead*.

ledger—The book of business or list of clients for whom a PIC has primary billing responsibility.

leverage—The total number of people in the firm, department, office, or other practice unit divided by the number of owners.

mandatory services—Routine periodic write-up, financial statement preparation, compilation, review and audit services; including the preparation of routine sales tax and payroll tax returns and tax reporting forms *that require no element of judgment* and routine worker's compensation audits.

margin—Economic gross profit percentage on standard fees, before write-downs.

markup—See *write-down* and *write-up*.

MCS—Management consulting service.

MIS—Management information system; the accounting and reporting system, which provides operating information useful in making management decisions.

net fees—See *net sales*.

net sales—The amount actually invoiced for a particular service or engagement, as compared to standard fees. Standard fees plus or minus write-ups/write-downs.

net income—The amount remaining for distribution to the owners of a practice after paying all other expenses such as rent, staff payroll, taxes, facilities, and so forth.

nonchargeable hour—An hour spent that is not chargeable to a client. This includes training, recruiting, professional meetings, practice development, administration, and firm meetings, regardless of whether the time is spent during regular business hours or not. It also includes civic activities, vacations, holidays, sick leave, paid personal time, and authorized leaves of absence during business hours.

opportunity cost—The measurable value of benefit given up by forgoing a favorable or advantageous opportunity in favor of another. The value of either a sacrifice made or a chance for progress or advancement.

overhead—Indirect operating expenses such as rent, utilities, taxes, interest, training, and professional expenses, but excluding salaries and wages and direct client expenses.

overtime—Hours spent on both chargeable and nonchargeable activities in excess of standard hours.

owner—A partner or significant shareholder of a professional service firm. All owners are assumed to be active executives in the firm. Employees below executive level owning nominal interests in the firm are not included in this definition.

PIC—Person in charge; the executive responsible for managing the firm's services to, and billing for, a particular client or engagement. The person to whom the client would first turn for a question regarding the client's service or bill.

planned write-down—A write-down that was anticipated before the engagement was accepted and agreed to for marketing or other reasons. For example, an engagement anticipated to cost \$14,000 at standard rates is undertaken for an agreed fee of \$10,000. \$4,000 is the planned write-down. If the engagement is performed for \$15,000, \$4,000 of the total \$5,000 write-down is planned. The PIC would only be held responsible for \$1,000 as an unplanned write-down. If the engagement is completed for \$12,500, the planned write-down is still \$4,000, and the PIC would be recognized for a \$1,500 write-up.

productivity—See *utilization*.

realization—The percentage or amount of standard fees actually billed.

reimbursable costs—See *direct client expenses*.

standard—Usually refers to *standard billing rate* or *standard fees*.

standard billing rate—See *standard chargeout rate*.

standard chargeout rate—The fee per hour established by the firm for each person in the firm.

standard fees—Total chargeable hours times the applicable standard chargeout rates. Also known as *gross fees*.

standard hours—Eight hours per day, five days a week, 52 weeks a year, or 2,080 hours per year. In some countries, standard is seven hours per day, or 1,820 hours per year.

support personnel—Administrative, office, and clerical personnel whose primary function is to support the client-service efforts of the *technical staff*. Support functions include typing, proofing, copying, printing, binding, messenger service, and billing. Support personnel may work on many different clients each day. They normally work in the firm's office.

technical staff—Technically trained personnel whose primary function is to work directly with or for clients, usually one client at a time, and often in the field.

total hours—Annual chargeable and nonchargeable hours (includes overtime, holidays, vacations, sick leave, etc.)

utilization—Average annual chargeable hours per person. Also, the number of chargeable hours divided by total hours.

value pricing—Pricing services based on their value to clients, rather than on the CPA's cost to provide them.

VAS—Value-added services; tax return preparation *that requires an element of judgment*, consulting and planning services, whether personal, financial, or business. This includes sales and/or use tax examinations because they require extensive negotiating skills.

WIP—Work in progress; the amount attributed to work performed for clients (the chargeable hours times the standard chargeout rates plus direct client expenses incurred) but not yet invoiced, often stated at standard fees. If stated at standard, an allowance for possible write-downs is usually deducted from the total in presenting the firm's financial statements. Some firms value work-in-progress at cost instead of at standard rates.

write-down—The amount by which standard fees (including direct client expenses) are reduced to arrive at the amount invoiced (net sales). Like write-ups, write-downs are often expressed as a percentage of standard fees. Other terms used are *billing adjustments*, *markups/markdowns*, *pluses/minuses*, *allowances*, and *fee adjustments*.

write-up—The amount added to standard fees and direct client expenses to yield the amount invoiced. Like write-downs, write-ups are often expressed as a percentage of standard fees. Other terms used are *billing adjustments*, *markups/markdowns*, *pluses/minuses*, *allowances*, and *fee adjustments*.

BIBLIOGRAPHY OF RECOMMENDED READING, LISTENING, AND VIEWING

Books

- Aquila, August J. *Breaking the Paradigm: New Approaches to Pricing Accounting Services*. New York: American Institute of Certified Public Accountants, Inc., 1995.
- Bachrach, Bill. *Values-Based Selling*. San Diego: Aim High Publishing, 1996.
- Baker, Ronald J. *2001 Professional's Guide to Value Pricing*. New York: Aspen, 2001.
- Cottle, David W., *Managing by the Numbers: Monitoring Your Firm's Profitability*. New York: American Institute of Certified Public Accountants, Inc., 1993.
- _____, *Managing for Profitability: How Winning Professionals Earn What They're Worth*. Miami: David Cottle Consulting, 1993.
- _____, *Professional's Guide to Target Marketing: How to Gain Profitable New Business*. New York: Harcourt, Inc., Aspen Publishers, Inc., 2000.
- _____, *Special Report—Seven Causes of Unplanned Writedowns and How to Avoid Them*. David Cottle Consulting, 1998, 2001.
- Drucker, Peter F., *The Effective Executive*. New York: Harper & Row, 1985.
- Larson, Charles B. and Larson, Joseph W. *Innovative Billing and Collection Methods That Work*. New York: 1994.
- Russo, J. Edward and Schoemaker, Paul L. H., *Decision Traps: The Ten Barriers to Effective Decision-Making and How to Overcome Them*. New York: A Fireside Book, Simon & Schuster, 1989.
- Weiss, Alan. *Million Dollar Consulting: The Professional's Guide to Growing A Practice*. New York: McGraw-Hill, 1992.

Audio Programs

- Cottle, David W. *Double your income! How winning CPAs make \$200,000 per year*. Palm City, Florida: David Cottle Consulting, 1990.
- _____. *Discover the fortune lying hidden in your practice!* Palm City, Florida: David Cottle Consulting, 1991.
- _____. *How to Gain Profitable New Business*. AICPA Practitioners Symposium. Tapes AI-00-08-40A and B. © 2000 by David W. Cottle. Available at www.conferencemedia-group.com. (Speaker(s): David W. Cottle)

Video Programs

Cottle, David W. *Be Prepared to Manage*. Palm City, Florida: David Cottle Consulting, 1998.

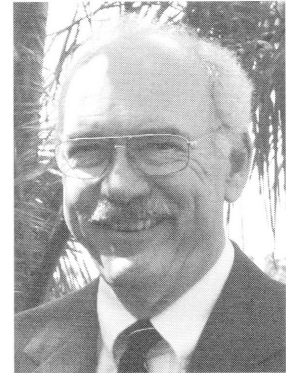
_____. *Be Prepared to Bill What You're Worth*. Palm City, Florida: David Cottle Consulting, 1998.

ABOUT THE AUTHOR

David W. Cottle, CPA, CMC

David Cottle consults with professional firms and other businesses on the following:

- Profitability improvement
- Marketing
- Client/customer service improvement
- Executive leadership skills
- Executive compensation
- Strategic planning and management



He has authored five books; nine audiocassette programs; and seven videos on profitability, management, marketing, and customer/client service based on his experience working with companies in 40 states in the USA and in 15 other countries. Attendees at his programs include executives American Express, Ceylon Brewery, Citibank, Colombo Dockyards, Confifi Hotels, and Coopers & Lybrand.

Firm Practice Management Resources from the AICPA

For more information, or to order, call 1-888-777-7077. Or visit www.cpa2biz.com/store. Prices subject to change.

AICPA's Management of an Accounting Practice (MAP) Handbook. The AICPA practice management classic—available in online and print formats:

- **e-MAP.** This vast online collection of practice management guidance and tools is a complete reference toolkit for managing small to medium-sized firms and solo practices. Interactive worksheets, spreadsheets and checklists in Word and Excel, powerful search engine, and regular updates make **e-MAP** a valuable resource for boosting profitability. (No.MAP-XX). 1-year subscription, AICPA Member \$150.00, Nonmember \$250.00.
- **Three-volume looseleaf.** The print version provides more than 1,600 pages with over 300 easy-to-use practice aids (No.090407). Updates shipped annually. AICPA Member: \$138.00, Nonmember: \$172.50.

Selected Readings—Management of an Accounting Practice. A perfect companion to the **MAP Handbook**, this annual edition is comprised of helpful articles chosen specifically for their profit-making ideas for your practice (No.090475). Paperbound. AICPA Member \$36.00, Nonmember \$45.00.

Seven Principles for Effective Firm Management, by J. Curt Mingle, CPA. A real-world guide filled with exhibits and examples to help create a more effective and efficient working environment (No. 090480). 2002, paperbound. AICPA Member \$39.20, Nonmember \$49.00.

Mastering the Art of Marketing Professional Services: A Step-by-Step Best Practices Guide, by Allan S. Boress, CPA, CFE and Michael G. Cummings. The tips, tools, techniques and how-to guidance you need to be more successful (No.090474). 2002, paperbound. AICPA Member \$59.20, Nonmember \$74.00.

Double Digit Growth: Tools from Top Firms, by Jean Marie Caragher. A profile of twelve CPA firms that have had double-digit growth every year for the past several years (No.090465). 2000, paperbound. AICPA Member \$36.00, Nonmember \$45.00.

Solo Practice: An Owner's Manual for Success, by J. Terry Dodds, CPA. A compilation of the author's thoughts, opinions, suggestions and advice with input from 13 prospering solo practitioners (No.090463). 1999, paperbound. AICPA Member \$48.00, Nonmember \$60.00.

Also Available—

AICPA Client Newsletters: Tools for Marketing Your Firm.

- **CPA Client Bulletin**
- **CPA Client Tax Letter**

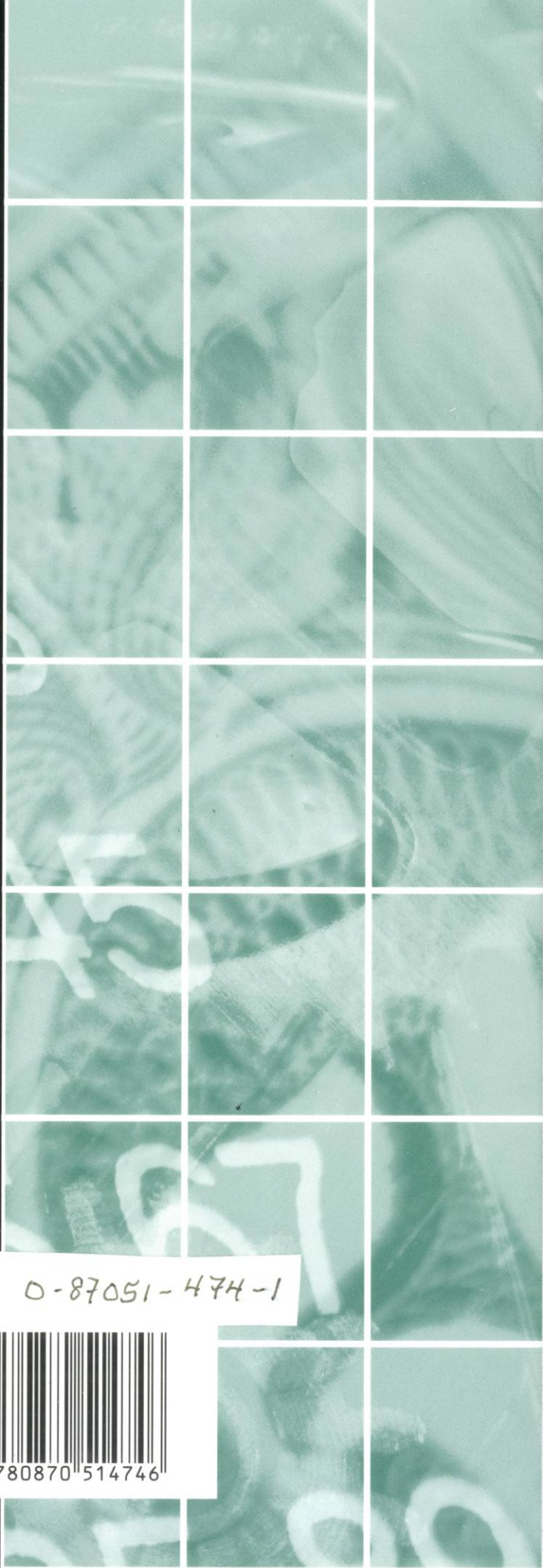
Increase Your Personal Marketing Power: Relationship Skills for CPAs (No.090417)

CPAs That Sell: A Complete Guide to Promoting Your Professional Services (No.090420)

Breaking the Paradigm: New Approaches to Pricing Accounting Services (No.090401)

The Communication Advantage: How to Effectively Share Information with Clients and Employees (No.090449)

The Marketing Advantage—How to Get and Keep the Clients You Want (No.090404)
Marketing Advantage II—New Ideas on Getting and Keeping Clients (No.090437)
101 Questions to Ask Your CPA (No.990102)
Practice Continuation Agreements: A Practice Survival Kit (No.090210)
Winning Proposals: A Step-by-Step Guide to the Proposal Process (090390)
On Your Own! How to Start Your Own CPA Firm (012641)
How to Hire a Marketing Director and Make It Work (090415)
Turning Sales Over to the Pros: Fourteen CPA Firms Share Their Experiences (090416)
Creating a Virtual Office: Ten Case Studies for CPA Firms (090426)
Firm Retreats: A Step-by-Step Guide for CPA Firms (090428)



ISBN 0-87051-474-1



9 780870 514746

090479