Winning the new ballgame: planning for growth in a post-recession economy

Michael J. Ramos
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By Michael J. Ramos

Sponsored by the Private Companies Practice Section (PCPS)
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Part 1: Current Conditions and Immediate Response
May You Live in Interesting Times

The Chinese say, “May you live in interesting times.” The use of this phrase is neither proverbial nor divine in nature, rather, it is said as a curse to someone you don’t particularly care for. It’s easy to see why. Interesting times are characterized by upheaval, as long-established customs and conditions abruptly cease to exist. Uncertainty about what will come next breeds anxiety and fear. You wouldn’t want to live in interesting times.

Or would you? After all, what is the opposite of “interesting?” Dull? Wouldn’t it be worse to live in dull times, where nothing ever changes, and have no chance to do anything different or to improve your lot in life? To live in interesting times is to be engaged and presented with unique opportunities that didn’t previously exist.

In a famous speech given at the University of Cape Town, South Africa in 1966, Bobby Kennedy spoke of the great social unrest of his times and referenced the Chinese curse. He then added, “Like it or not, we live in interesting times. They are times of danger and uncertainty; but they are also the most creative of any time in the history of mankind.”

Like it or not, we now live in interesting times, though our great challenges are economic, not social. The status quo is rapidly crumbling, much of it unlikely to return. Stability, when it does return, will usher in a brave new world. CPA firms now have choices to make, not only about how to deal with current economic conditions, but
about how to position themselves for the new business environment that will emerge when the current crisis gives way to that as yet undefined set of conditions that will shape our new norm.

Current Economic Conditions

A Deep Recession With a Prolonged Effect

Over the past few months, CPA firms have seen their clients report losses and weaker balance sheets. They have watched clients struggle through liquidity issues, employee layoffs, and severe cost cutting measures. Some of their clients have declared bankruptcy; others are seriously at risk of it, for the first time ever.

You don’t need to be an economist to know there has been a severe downturn in the economy. It doesn’t matter whether we call it a recession, depression, or something else. What does matter is how bad it will get and how long before it gets better.

The global recession that began in December 2007 is now nearly a year and a half in duration with no clear ending in sight. In the United States alone, the gap between what we are capable of producing and the country’s actual output is more than $1 trillion. If the recession ended tomorrow, and the U.S. economy began to expand at historically typical rates (around 2.5 percent) it would take 3 years to return to its prerecession size. Only once since the Great Depression has there been such a large drop in economic
output, the recession of 1981–1982. It took the economy 7 years to recover from that recession.¹

In the second quarter of 2009, a few leading economic indicators began to show signs of life. Stocks are up; interest rates are down; the rate at which the economy is shedding jobs has decreased dramatically. These are promising signs to be sure. But this recession is deep, and it will be with us for some time. CPAs who look to the first positive indicators and presume that the worst is over and things will be back to normal soon are likely to be disappointed.

The decrease in demand is broad-based. An economic analysis in The New York Times notes, “Lawyers are booking fewer hours. Retail space goes begging. Tourism is down. So is cell phone use, airline bookings, freight traffic and household borrowing, which is less than half what it was on the eve of the recession.”² Manufacturing has been hit especially hard. Excess manufacturing capacity is at its highest level since records were first kept in 1948. It would be surprising to find a CPA that does not have at least some clients affected by the recession.

To help you navigate the current economy, the following pages summarize background and some of the salient features of the recession and the federal government’s efforts to mitigate the damage.

² Ibid.
The Credit Crisis

Economic historian, Niall Ferguson, describes the current economic crisis as “a fundamental breakdown of the entire financial system, extending from the monetary and banking system through the bond market, the stock market, the insurance market and the real-estate markets.”

Your clients may not be directly involved in any one of these industries, but because of the structure of modern financial system, a seemingly isolated breakdown can ripple throughout the entire system and affect businesses far removed from Wall Street.

The current crisis began with defaults in subprime mortgage loans, most of which were securitized, repackaged into a variety of different investment vehicles, and sold to investors. As mortgage delinquencies increased, investors became nervous about the quality of the underlying assets and the soundness of the financial institutions that originated them. They stopped buying mortgage-backed securities. Without an active secondary market, banks faced a liquidity crunch and had no option except to curtail lending. As the value of the homes underlying the securitized assets continued to fall, the value of the banks’ investments also dropped, reducing their capital, which lead to even further pressure to reduce lending.

The ultimate result was that individuals, governmental entities, financial institutions, and businesses large and small were unable to obtain credit. Many of the small and medium sized businesses that form the bulk of the

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client base for most CPA firms were blindsided by the magnitude and swiftness of the liquidity crunch that they soon faced. Credit lines were reduced or not renewed, and access to other credit facilities necessary to finance inventory or accounts receivable became constricted.

The liquidity and credit crisis has had a devastating impact on the banking industry. In the 16 months since the recession began, 46 banks have failed. By comparison, only 27 banks failed in the 7 years preceding the start of the current recession.

**Unemployment**

Since the beginning of the recession, the U.S. economy has shed over 5 million jobs, 2 million during the first quarter of 2009 alone, and that number will continue to climb. Construction, manufacturing, and business and professional services were particularly affected.\(^4\) At the end of the first quarter of 2009, the unemployment rate stood at 8.5 percent, the highest level in 25 years. Economic forecasters in the Obama administration expect even more jobs to be lost and the unemployment rate to hit 10 percent by the end of the year. Many economists now predict a jobless recovery, one in which the gross domestic product increases but high unemployment rates remain for some time.

Of all the sectors of the economy, the auto industry has arguably suffered the most, having already lost 400,000 jobs. Melissa Armstrong, senior director of the Research

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and Information Center at the Detroit Regional Economic Partnership, puts these job losses in context.

Manufacturing jobs, and more specifically automotive industry jobs, are known for their high “multiplier effect.” When an auto manufacturer purchases supplies and services from other companies this creates jobs. When that same manufacturer pays its employees, those employees turn around and spend that money in a variety of ways, also creating jobs. This multiplier effect trickles down to all sectors of the economy. Estimates of the multiplier effects in the auto industry range from 2 to 10—for every manufacturing job another 1 to 9 additional jobs are created or sustained.5

On April 30, 2009, Chrysler filed for bankruptcy, emerging two months later a stronger and more viable company.

The expectations for General Motors (GM) were much worse. On June 1, 2009, the company filed for bankruptcy, closed 17 factories and parts centers, and announced further layoffs of 20,000 people in 4 states. Because of the size and structure of GM, their bankruptcy is expected to last much longer and be more complicated than the Chrysler bankruptcy. The GM bankruptcy could lead to the loss of even more jobs, which, because of the multiplier effect, would ripple throughout the economy.

High unemployment rates, if not addressed, can put even more pressure on the availability of credit. At the beginning of the recession, home foreclosures were limited to subprime loans and to borrowers who arguably should not have been granted loans in the first place. We are now beginning to see a second wave of foreclosures by homeowners who were qualified borrowers but now can no longer afford their mortgages after the loss of their jobs.

The Federal Government’s Response to the Economic Crisis

During the current recession, it is common for writers and analysts to comment that a given economic indicator has not been this bad since the Great Depression or the U.S. recession of 1981–1982. It is worth noting that those once-in-a-generation economic crises prompted significant government intervention: Franklin Roosevelt’s New Deal and the so-called Reagan Revolution of the 1980s.

Significant shifts in business and economic policies create many opportunities for business professionals, including CPA firms. For example:

- the New Deal brought us the Securities and Exchange Commission, which granted CPAs the exclusive right to perform financial statement audits and thus launched the modern auditing profession.
- deregulation and major revisions to the tax code in the 1980s fueled the growth of many CPA firm consulting and tax practices. The subsequent
fallout from deregulation (for example, the savings and loan crisis at the end of the decade) proved to be a source of consulting opportunities for finance professionals.

Because public policy change can be a driver of new business opportunities, CPA firm leaders would be well advised to understand the emerging changes as fully as possible. As of the end of the first quarter of 2009, the current administration has taken steps or announced plans to address the economic crisis with the following collection of interrelated initiatives:

- The American Recovery and Reinvestment Act (the ARRA or stimulus bill)
- The federal budget
- The bank bailout plan
- Regulatory reform
- Other federal government actions

The American Recovery and Reinvestment Act

As discussed previously, the gap between capacity and demand is at historically high levels, and this measure is closely related to unemployment levels. The ARRA was designed to stimulate demand, close the capacity gap, and create or save 3.5 million American jobs.

The cost of the total stimulus package is $787 billion; about 40 percent of the package is targeted for tax relief, with the remaining 60 percent for government spending.
Tax Relief

The stimulus bill includes about $100 billion in tax breaks for individuals. These tax law changes will affect many millions of individual taxpayers, and they include items such as a first-time home buyer credit, tax credits for higher education and an expansion of college savings plans, and tax credits for individuals and married couples filing jointly. Nearly $200 billion of the stimulus bill is targeted for business tax breaks, including numerous provisions aimed at small businesses. These small business tax provisions include raising the limit on Section 179 expensing, expanding the carry-back of net operating losses, and an extension of the section 168(k) bonus depreciation.

The tax law changes included in the stimulus bill are extensive. Your firm’s expertise on tax matters will be invaluable to your clients as they seek to understand these changes and apply them to their situation.

Federal Government Spending

The stimulus bill includes approximately $350 billion of direct federal government spending whose aim is to make investments that will position the economy for future growth. Those investment priorities are
- public infrastructure and science;
- education and training;
- healthcare; and
- renewable energy.

(cont.)
The following table summarizes the tax relief and federal spending contained in the stimulus bill.*

<table>
<thead>
<tr>
<th>Targeted Area</th>
<th>Tax Relief</th>
<th>Spending</th>
<th>Total Stimulus</th>
</tr>
</thead>
<tbody>
<tr>
<td>Infrastructure and Science</td>
<td>15</td>
<td>111</td>
<td>126</td>
</tr>
<tr>
<td>Protecting the Vulnerable</td>
<td>61</td>
<td>81</td>
<td>142</td>
</tr>
<tr>
<td>Education and Training</td>
<td>25</td>
<td>53</td>
<td>78</td>
</tr>
<tr>
<td>Renewable Energy</td>
<td>22</td>
<td>43</td>
<td>65</td>
</tr>
<tr>
<td>Healthcare</td>
<td>—</td>
<td>59</td>
<td>59</td>
</tr>
<tr>
<td>General Tax Relief</td>
<td>165</td>
<td>—</td>
<td>165</td>
</tr>
<tr>
<td>Other</td>
<td>—</td>
<td>8</td>
<td>8</td>
</tr>
<tr>
<td><strong>Total Stimulus</strong></td>
<td><strong>288</strong></td>
<td><strong>355</strong></td>
<td><strong>643</strong></td>
</tr>
</tbody>
</table>

Most CPA firms will focus on the tax changes proposed by the stimulus bill but note that the spending elements of the plan are larger. In addition to the $355 billion to be spent at the federal level, state governments will receive an additional $144 billion to be spent in their states. Combined, planned spending increases are almost twice the tax cuts.

You also should note the segments of the economy where the money will be spent. Companies that operate in these industries (for example, solar or wind power companies) have the potential for significant growth over the next few years. CPA firms looking to grow should consider developing or expanding their practices in these industries.

* "Where is Your Money Going?" Recovery.gov, April 8, 2009.
State and Local Fiscal Relief

The stimulus bill also includes $144 billion that will flow directly to state and local governments. In general, these funds will be used to prevent state and local cuts to health and education programs (or to prevent increases to state and local taxes that otherwise would be required to keep the existing programs in place).

At the time this book was written the exact amount to be received by each state was still to be determined. Most states have set up a Web site to provide you with information about the funds it will be receiving and how they will be spent. One way to access this information is to go through the portal at the federal government’s Web site. (http://www.recovery.gov/?q=content/state-recovery-page). Understanding which programs in your state are receiving aid will help you identify growth areas for your firm to target.

Transparency and Accountability

The stimulus bill creates unprecedented levels of transparency and accountability. Agencies that receive stimulus funds are required to take steps that go well beyond standard practice, including matters that traditionally have fallen within the CPA’s area of expertise. These requirements include

- financial and nonfinancial reporting;
- data and information collection and processing;
- budget preparation and execution; and

(cont.)
- risk assessment and the implementation of internal controls.

Many recipients of stimulus funds will not have the accounting and control systems in place to meet these reporting requirements. This is especially true of smaller not-for-profit organizations, many of which may not be familiar with the general audit and reporting requirements affecting recipients of federal funds.

CPA firms that have an expertise in federal government reporting and auditing requirements, especially those relating to the stimulus bill, have a significant opportunity to provide valuable advice to stimulus fund participants.

The Urgency of Now

In order to effectively stimulate job growth, funds from the stimulus bill must be injected into the economy quickly. Federal agencies and state and local governments have been directed to award grants and spend their money as fast as possible.

However, the amount of stimulus money provided to some agencies is staggering. To cite two examples

- The annual budget for the Department of Education typically runs around $40 billion. Under the stimulus plan, the department will receive over $80 billion, effectively doubling its fiscal year (FY) 2009 budget.

- The capital improvements budget for the Department of the Interior normally is around $150 million. Under the stimulus plan, that budget will increase 20-fold to $3 billion.
The Federal Budget
By early April 2009, both the House and the Senate had passed budget resolutions that were largely consistent with the budget proposed earlier by President Obama. The differences between the House and Senate budgets will be reconciled in the summer of 2009, resulting in one jointly produced concurrent resolution. This concurrent resolution then serves as a framework for passing separate laws, called reconciliation bills to carry out the various provisions of the budget.

Spending
The spending provisions in the budget are consistent with the priorities established in the stimulus plan. The President has indicated that one of his main priorities is to set the country on a path for long-term growth by redirecting funds to make significant investments in the following key areas:

- **Energy.** Energy policy will direct funds to increasing renewable energy capacity and making the country more energy efficient.

(cont.)
Education. The budget includes significant outlays for programs to make college more affordable, to invest in early childhood education, and to raise academic standards by improving tests and teacher training. There is also money for the first-ever federal pay-for-performance plan, which would reward the nation’s best classroom teachers with higher pay. The budget also includes a plan to completely revamp the student loan program.

Healthcare. The President’s budget includes a $633 billion “downpayment” on healthcare reform. Details of the healthcare plan remain to be worked out by Congress.

Infrastructure. The budget provides funding to repair roads, bridges, and schools and to expand broadband access into rural areas.

Taxes

The tax law changes included in the budget would close a number of loopholes in the current tax code. The plan also includes a tax cut for families making under $250,000 per year and an increase in the top marginal tax rate to 39 percent. This tax hike on high income taxpayers would be accomplished by allowing the Bush administration tax cuts to expire in 2010 as originally scheduled. Details of the tax law changes remain to be worked out through the budget reconciliation process.
Implications for CPA Firms

In many respects, the economic blueprint contained in the FY 2010 budget is a continuation of the policies and priorities enacted in the stimulus bill. CPA firms that identify business development opportunities driven by the stimulus plan should not consider these “one-off” opportunities. The stimulus plan is just a big first step in what promises to be a long-term commitment by the federal government. For example, if the stimulus bill gives your firm an opportunity to provide services to alternative energy companies, your decision to pursue that opportunity should take into account the fact that the federal government will continue to invest to encourage innovation and attract private capital to the industry. The end goal would be to create an alternative energy industry that is self-sustaining and that ceases to require government involvement to thrive.

Thus, at the time this book was being written, no new laws were passed and it is likely that the final bills will differ from what is contained in either of the two budgets. However, the general provisions of the House and Senate budgets are similar and should be considered a reliable blueprint for what will come.

The Bank Bailout Plan

In October 2008, Congress passed and President Bush immediately signed the Emergency Economic Stabilization Act of 2008. Among other elements of the plan was a provision to allocate $700 billion to stabilize the U.S. financial system under a program titled, the Troubled
Asset Relief Program (TARP). Initially, this money was to be used to purchase illiquid mortgage-related assets from banks. However, in November 2008, the U.S. Treasury changed courses and used the money to directly inject capital into troubled banks through the purchase of equity. The intent of the capital injection was to shore up the banks’ balance sheets, which would help them resume lending.

In December 2008, the Government Accountability Office published its first report on TARP to Congress. This report noted specific “areas that warrant Treasury’s ongoing attention.” Recommendations that may be of particular interest to CPA firms and the accounting profession include the following:

- Continue building a base of employees to carry out and oversee TARP.
- Ensure that appropriate amounts of personnel are assigned to oversee the performance of all contractors hired to execute TARP.
- Continue to develop a comprehensive system of internal controls over TARP activities.

In February 2009, Treasury Secretary, Tim Geithner, laid out a more comprehensive approach to addressing the credit crunch by restoring bank stability. The plan could buy up to $2 trillion in illiquid real estate assets that have clogged up bank balance sheets and prevented them from lending. The three main components of the plan are as follows:
- Purchase bundles of whole mortgages. The Federal Deposit Insurance Corporations (FDIC) will oversee a program in which banks auction off bundles of mortgages to investors such as hedge funds, pension funds, or private equity funds. The plan calls for the government to lend as much as 85 percent of the purchase price for each portfolio and to invest one dollar of taxpayer money for every dollar of private equity to cover the remaining 15 percent of the purchase price. This program is very similar to the distressed asset sales arranged by the Resolution Trust Corporation to address the savings and loan crisis in the early 1990s.

- Public-private investment funds. The Treasury will help finance investment funds to purchase illiquid mortgage-backed securities. In connection with this program, in April 2009, the Treasury announced that it is encouraging several large investment companies to create bailout investment funds, similar to mutual funds, that would give individuals a chance to invest in troubled mortgage securities and participate in any appreciation in value.

- Term Asset-Backed Securities Loan Facility (TALF). The TALF program will support the issuance of asset-backed securities collateralized by student loans, auto loans, credit cards, and loans guaranteed by the Small Business Administration.

In some ways, the federal government’s response to the current banking crisis is reminiscent of the response to the savings and loan crisis in the late 1980s. Then, the
government formed the Resolution Trust Corporation (RTC) to acquire and dispose of troubled real estate assets held by savings and loans.

Many CPA firms and individual CPAs provided services to the RTC in response to the savings and loan crisis by helping them at various stages in the acquisition and disposal process. Some of those firms who provided services to the RTC then are seeing similar opportunities to assist the Treasury or FDIC workout troubled assets clogging the financial system today.

Regulatory Reform
For over a year, both Republicans and Democrats have called for comprehensive reform of the financial regulatory system. Former Treasury Secretary, Hank Paulson, issued his “Blueprint for Regulatory Reform” in March 2008. While he was a presidential candidate and Illinois senator, Barack Obama similarly called for modernization of financial regulations 6 months later.

In March 2009, Treasury Secretary Geithner laid out the new administration’s plan for regulatory reform, which builds upon many of the ideas recommenced by his predecessor’s plan. The four cornerstones of the new regulatory system are

- addressing systemic risk;
- consumer and investor protection;
- eliminating gaps in the regulatory structure; and
- international coordination.
Changes to the regulation of financial institutions will have a direct effect on CPA firms that provide services to the financial industry. Details of the regulatory reform plan are still to be determined and should be closely followed.

Other Federal Government Actions

Federal Reserve Bank Intervention

In March 2009, the Federal Reserve increased its purchases of mortgage-backed securities by $750 billion (previously, it had committed to purchase $500 billion) and doubled its purchases of debt in Fannie Mae and Freddie Mac to $200 billion. These actions were intended to lower mortgage rates, and within a month, rates on 30-year fixed-rate mortgages had indeed dropped to an average of around 5 percent.

The Federal Reserve also said it will buy $300 billion in long-term Treasury bonds, a move that will lower long-term interest rates for the U.S. government directly and, hopefully, will lead to lower borrowing costs for businesses and individuals.

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6 At the time this book was being written, healthcare reform was the administration’s number one priority. The issue dominated the news in the summer and early fall of 2009. This initiative was not a direct response to the economic crisis, though it certainly will have a huge impact on certain segments of the economy. The legislation also may affect human resource decisions of many businesses, large and small, who may be required to provide health insurance benefits or contribute toward funding health insurance for the currently uninsured. A detailed analysis of the pending healthcare reform bills now in Congress and the possible impact those may have on businesses and their CPAs is outside the scope of this book.
Foreclosure Plan

In an effort to stem home foreclosures, in February 2009, the administration unveiled its Homeowner Stability Initiative, which provides a set of incentives for lenders to cut monthly mortgage payments to no more than 31 percent of a homeowner’s income. Only certain homeowners will qualify for the program.

Changes to Defense Department Spending

At the time this book was being written, Secretary of Defense, Robert Gates, had just released his FY 2010 budget, which calls for an increase in defense spending. More significantly, the new budget signals a change in defense spending strategy and redirects spending away from legacy defense contractors to “small war” weapons and programs at the expense of big ticket more traditional programs, such as aircraft carriers, high-tech surface warfare, fighter aircraft, air transports, and strategic missile defense.

CPAs that provide services to defense contractors and their suppliers should carefully evaluate the effects of these changes to identify new business development opportunities.

Your Firm’s Immediate Response

As the realities of the recession begin to sink in and the government’s responses begin to have an effect, your firm will need to develop a response. Some firms believe that since the recession has had little to no impact on
their clients or them, there is no need to make any changes. In the short term, standing pat may be sufficient, but in the long term, firms that make no changes to their pre-2007 business model run the risk of being overtaken by their competitors.

During a recession, the biggest risk to a firm is choosing to stand pat. Many of those around you are taking action and moving forward. For example:

- Your clients must respond to tightening credit markets and drops in demand for their products and services.
- Your peer firms are pursuing new business development opportunities, laying off employees or partners, or actively seeking to merge.
- Your staff, your competitors’ staff, and recent college graduates all are evaluating their futures in the context of current economic conditions.

Firms that choose to stay the course not only miss the chance to cash-in on new opportunities, but they risk becoming anachronistic. If your clients are aggressively fighting to stay viable in these difficult economic times but see their most valuable financial advisor acting as if nothing has changed, won’t they begin to wonder if their CPA advisor “gets it”?

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7 My own experience and observations have led me to believe that the risks of doing nothing in a recession are real and significant. It is also worth noting that recent studies by IBM and Boston Consulting reach this same conclusion. (See the 2009 whitepaper “Succeeding in the New Economic Environment: Focus on Value, Opportunity, Speed,” by Saul Berman et al., which is available from IBM Global Business Services Web site; and David Rhodes and Daniel Stelter’s “Seize Advantage in a Downturn,” Harvard Business Review, February 2009.)
To be clear, this is not intended to advise taking action just to be perceived as doing something. Rash or careless action can be nearly as damaging as no action. The purpose of this section is to help you strike a balance between aggressive action and standing pat, so that your firm is stronger coming out of the recession than it was going in.

Priority 1: Get Your Financial House in Order

Bill and Collect

As a general rule, accounting firms have extremely high receivables and work in progress balances. The most recent AICPA Management of an Accounting Practice (MAP) survey indicates that, on average, a CPA firm has nearly 4 months of gross billings tied up in receivables and unbilled work. Moreover, nearly 30 percent of total receivables are more than 90 days old. If the average CPA firm simply collected its overdue receivables, it would have enough cash to pay its expenses (including salaries) for 4 weeks.

In a recession, cash is king. Your first move should be to collect your current outstanding receivables. Or better yet, use your experience in collecting receivables now to institute lasting changes in your billing and collection procedures.

Adjust Your Client Mix

Not all clients are created equal. The AICPA Private Companies Practice Section (PCPS) notes that 20 percent of your firm’s clients account for 80 percent of your firm’s profits.
The PCPS recommends that you regularly evaluate your clients, and use this evaluation as a starting point for your client retention plan; focus on the best clients, terminate relationships with the worst ones, and work to improve the relationships with all those in the middle. The current recession provides a perfect rationale for explaining to those clients you terminate why your firm can no longer provide services to them.

To meaningfully evaluate your clients, you will first need to assess the key financial metrics for each one. These metrics typically include profitability, margin, number of billable hours, and gross fees. The PCPS also recommends making more subjective evaluations of the client, which might include:

- whether the client is a reliable referral source.
- the client’s growth potential and your firm’s ability to provide additional services in the future.
- your firm’s ability to provide services to the client that currently are performed in-house or by another firm.
- whether you enjoy working with the client.
- the relative risk the client poses to the firm, for example, the risk profile of the industry in which the client operates, or management’s attitude toward internal control or tax positions.

**Tune Up Your Key Performance Indicators**

The main profit drivers in a professional services firm are

- *leverage*. The ratio of staff to partners.
- *utilization*. The ratio of billable staff hours to total available staff hours.
Partner profitability is a function of these key variables

$$\text{Profitability} = \text{Margin} \times (\text{Revenue per Professional}) \times \text{Leverage}$$

Revenue per professional is a function of utilization and billing rates. The primary cost of service is salaries, so margin is a function of the relationship between the compensation levels of your staff and their billing rates. Thus, the three key performance metrics are leverage, utilization, and billing rates.

Every two years the AICPA publishes its MAP survey, which tracks these and other performance measures for thousands of CPA firms. These statistics are organized according to firm size and geographic location, which makes it easy for you to benchmark your firm against your peers. Those comparisons should be made as well as a careful evaluation of the differences between your firm and your peers. Small changes in just one of the key profit drivers can have a profound effect on partner profitability.

Consider the following example, based on averages from *The 2008 PCPS/TSCPA National MAP Survey*.\(^8\)

$$\text{\$216,000} = \text{30\%} \times \text{\$180,000} \times 4$$

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Suppose the firm partners benchmarked against their peers and decided to raise billing rates across the board by just 5 percent and, for example, partner rates went from $185 per hour to $195 per hour; entry level staff from $75 to $80 per hour. Raising billing rates increases both revenue per professional and margins, resulting in higher profitability.

\[
\text{\$ 265,000 = 35\% \times \$189,000 \times 4}
\]

Thus a very small increase in billing rates—$5 to $10 per professional—results in almost a $50,000 increase in profitability per partner.

**Evaluate Service Offerings and Fee Structure**

Even in the best of times, CPA firms struggle with pricing their services. During a recession, pricing decisions can become even more complex as firms are tempted to place fee reductions at the center of their client retention program. Rather than adopting across-the-board fee cuts, consider other options.

In their article "Seize Advantage in a Downturn," David Rhodes and Daniel Stelter discuss recommendations for addressing fee issues during a recession using research conducted by their consulting firm. Although the research was conducted primarily on companies that sell products, some of their observations about

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Offer Lower-Price Versions of Existing Offerings

Suppose your firm performs an audit for a client that is being hurt severely by the recession, and looking to cut costs, the client asks you to reduce your fees. Reducing fees will put pressure on you to reduce the hours you spend on the engagement, which you are loathe to do because it could compromise audit quality. On the other hand, if you can't provide the service cheaper, the client may take their business to a lower cost provider.

Consider a third option. In lieu of an audit, perhaps you could perform a lower cost assurance service, for example, a financial statement review or a review in combination with agreed-upon procedures. This type of assurance service may be perfectly acceptable to the financial statement users, and you can provide it for a much lower price than an audit while retaining your normal margin.

Identify Engagements for Which Clients Are Still Willing to Pay Full Price

Don’t assume that all clients will need or demand lower prices. Some segments of the economy are still doing well; some companies are in good financial condition and are aggressively looking to expand during the current recession. You will still be able to collect your full rates for some clients and certain types of engagements.
Unbundle Services and Adopt A La Carte Pricing

Do you really need to create a management letter for each audit client? Does client management find these letters valuable? If not, then don’t incur the cost to provide them. If management does find value in the letters, then they should pay for them.

Disaggregating your service offering and pricing the elements separately is another way to allow your clients to manage their costs and to prevent them from seeking other service providers. For example, you may have an audit client whose accounting records are always in disarray, which requires your firm to perform a significant amount of bookkeeping work in advance of the audit. Instead of including the bookkeeping services in the overall audit fee, it may be better for both your firm and your client if you break these out separately. Price the bookkeeping work at full rates. If the client pays, you come out ahead (chances are you’ve been getting less than standard rates for the bookkeeping). The client may decide to engage a bookkeeper and have you just do the audit, which benefits both parties; the client reduces their overall fees, and you divest yourself of low-margin work.

* The answer is “no.” SAS No. 115, *Communicating Internal Control Matters Noted in an Audit* (AICPA, Professional Standards, vol. 1, AU sec. 325), provides guidance on when an auditor is required to issue a management letter. In general, these letters are required only when the auditor identifies significant deficiencies or material weaknesses in a client’s internal control.
Winning the New Ballgame

Get Creative With Your Pricing

During the Great Depression, General Electric needed to sell big ticket appliances such as refrigerators in an economy with 25 percent unemployment. Their solution: finance the purchase price. Thus was born GE Capital Services, which over the next 60 years grew to account for one-third of GE's profits.*

Are there ways you can be more innovative in the way you price your services? How about a retainer, or some other arrangement that would allow your clients to spread out their payments?

Look for opportunities to increase your billing rates or move to a value pricing model. For example, recently enacted and proposed tax law changes give firms the chance to provide high value tax planning services for the first time in many years. For many clients, the value of these services is much greater than preparing an annual tax return, and you should therefore price these services accordingly.†

† For more information on value pricing, see the article “How to Implement Value Pricing in Your Firm” by Ronald J. Baker, which appeared in Journal of Accountancy, June 2009.

companies that fared best during economic downturns might be useful for service providers such as CPA firms.

Identify and Respond to Client Needs

One of the hallmarks of successful CPA firms is an ability to respond effectively to client needs. As your clients make changes in response to the current economic
environment, those changes may define a whole new set of needs. Changes in your clients’ needs will create new business development opportunities that imaginative and quickly moving firms will be able to exploit. One of the keys to taking advantage of these opportunities will be the ability to anticipate and analyze how your clients are responding to the current economic downturn.

At the end of 2008, the IBM Institute for Business Value surveyed CEOs and business leaders to identify successful strategies for being successful in the current economic environment. Among other tactical choices, the IBM consultants identified the following that may be of particular interest to CPA firms:

- **Working capital management.** Restrictions on credit have forced CEOs to focus on strategies for managing working capital and driving down inventory, receivables, and payables. To manage working capital effectively, company management may need consultative help in identifying and implementing effective cash management strategies. They also will need access to high quality, timely financial and non-financial information.

- **More sophisticated financial analysis.** The IBM study found successful companies using a variety of methods to rethink and redirect their businesses. Many of these methods require management to

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10 The results of the research and related analysis were published in the 2009 whitepaper “Succeeding in the New Economic Environment: Focus on Value, Opportunity, Speed,” by Saul Berman et al., which is available from the IBM Global Business Services Web site.
develop more formal or sophisticated financial analysis modeling. Among the various tactical choices recommended in their analysis, the following place a premium on financial analysis:

– **Active scenario modeling.** Your client’s management should perform a variety of analyses to evaluate how far production cost breakeven points must be lowered and capacity reduced (or used differently) to prevent losses. This scenario modeling also will allow your clients to plan for the eventual upturn in the market by avoiding cutting too deeply.

– **Strip out non-value-add activities and reduce non-core costs.** In order to do this, management must be able to analyze which activities contribute both strategically and financially to the bottom line.

– **Adjust product mix to target high value customers.** This recommendation is an application of the 80-20 rule: 80 percent of your clients’ profitability will come from 20 percent of its customers. In difficult times it is critical that they focus their efforts on the needs of their best customers.

– **Acquire under-valued assets.** Current economic conditions have created many bargains, which are available to clients that have a strong cash position or access to funding sources. Acquiring these assets now will position these clients well for
the long term. Management will have to carefully evaluate their options to determine which assets can deliver the best return on investment.

Providing reliable information to decision makers is a core strength of the accounting profession. As your clients understand and respond to the economic downturn, their need for high quality information will only increase. Being visible to your clients as a trustworthy and responsive source of this information could be a critical component of your strategy to grow and thrive in the current environment.

**Moving Beyond Your Initial Reaction**

There is no question that CPA firms have suffered alongside their clients. Firms have lost clients that have declared bankruptcy. Audit practices have been hurt by clients who convinced their lenders that an annual audit was no longer necessary. Firms have lost consulting engagements and special projects that fell victim to their clients’ cost-cutting measures. Not surprisingly, CPA firms have reacted by reexamining their own practices, laying off staff, and cutting nonessential expenses.

This knee jerk inclination to belt-tighten may be an understandable reaction, but when faced with uncertain economic conditions, cutting costs is not the only option, nor is it always the right option. Within this economy significant opportunities exist for business
development. Progressive firms will view current economic conditions with a clear eye toward these opportunities and marshal the resources to vigorously pursue them. How to do that is the subject of the remainder of this book.
Part 2: The Short Term
Once you move past your firm’s immediate response to the recession, you will want to consider taking steps that can produce measurable results in a one- to two-year period. Planning those steps will require more than a brainstorming session among the partners about new clients you might go after or new services to advertise. Instead:

- take some time to analyze your business and the nature of your service offering.
- use this deeper understanding to align your cost structure with your service offering.
- develop a structured, disciplined plan for generating new revenue in the coming year.

What Business Are You In?

Periodic self-reflection is a valuable tool. Answering the question “what business am I in?” may yield valuable insights about your firm and the direction you want to take it.

The Unique Business of an Accounting Firm

A professional services firm is much different from a typical commercial entity that produces and sells a product. These differences help explain the dynamics of certain strategic choices you must make, and they include the following:
Customized responses. Your deliverables are unique to each individual client. Even something as routine as a simple tax return or an audit must be tailored to consider the unique circumstances of the client.

A premium is placed on professional judgment. You are asked by your client to apply tax laws, accounting standards, or other bodies of relatively complex, abstract knowledge to their particular situation. To do that requires you to apply professional judgment on every engagement, and this ability is your single greatest source of competitive advantage.

Routines and procedures are not rigidly defined. Because of your clients’ need for customized responses and your dependence on the application of professional judgments the routines and standard procedures you rely on to deliver services are much less rigid than those required of a manufacturing process. Sure, CPAs love their checklists, but something like an off-the-shelf audit program is designed to be used as a memory jogger and not as a comprehensive set of instructions from which no deviation is tolerated.

Client relationships. CPA firms are much closer to their clients than the sales representative who provides a product. There is a symbiotic relationship between you and your clients that is unique to a professional services firm, and this relationship has its advantages and disadvantages. The primary
advantage is that the single biggest switching cost for a CPA firm client is the relationship with that firm.

- **Professional staff.** It has become cliché for a CPA firm to say “our people are our biggest asset,” but like all clichés, there is a fundamental truth to the statement. Human capital is an asset, and if your firm is to succeed, you have to treat it as an asset. You will make investments in your people, maintain their skills and knowledge, and do what you can to keep them satisfied and productive. A manufacturing company typically requires large amounts of capital to grow; conversely, a lack of capital can stifle growth. In a professional services firm, the analog is human capital. It is essential if your firm is to grow.

**The Accounting Firm**

The accounting profession has one additional quality that makes accounting firms different from other professional service firms. Unlike lawyers or management consultants, the CPA has a responsibility to maintain the public trust. That responsibility is required only by the attest function, but in fact qualities such as integrity and trust are ascribed to all CPAs and the services they perform. They have become part of the CPA brand.

To maintain that brand the accounting profession has an extensive set of rules related to independence and conflicts of interest that are unmatched by other professions. The accounting profession also has a peer review process to help ensure the quality of work CPAs perform.
These rules and quality assurance programs have a direct effect on how a CPA firm is managed and the strategic alternatives available for firms.

**Understanding Your Firm’s Service Offerings**

Many firms manage their practices according to subject matter expertise, for example, the tax department, audit and accounting, consultants. Other firms are organized around individual partners’ books of business, that is, partner A serves all the needs of one group of clients, partner B the needs of a separate group, and so on.

For strategic planning purposes it is helpful to look at your firm’s service offerings from a different perspective by focusing on the characteristics of those services that drive your value proposition. On any given engagement think of your services as primarily delivering one of the following three values:

- **Compliance** with regulatory or other requirements. Examples: tax return preparation, financial statement assurance services, write-up, and bookkeeping.

- **Solutions** based on applying learning from experience to specific circumstances. Examples:

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implementation of IT software, tax planning, more complex tax return preparation and financial statement assurance services.

- Problem-solving through the innovative and creative application of expertise to solve the client’s most difficult problems. Example: SOX 404 consulting (circa 2003).

These categories are not discreet and realistically should be thought of as being part of a continuum. Differences of opinion may exist as to where a particular engagement should be placed along the continuum. But the purpose of the exercise is not to categorize your services but to understand them in a way that allows you to better align your operations to the services you provide your clients.

**Compliance-Oriented Service Offerings**

Most CPA firms offer services that are geared primarily toward having their clients comply with regulatory requirements, debt covenants, partnership agreements or other obligations to report financial information. These engagements vary in terms of complexity, and you may have to bring a great deal of expertise to bear to complete these engagements. But it’s your client’s point of view, their perception of the value of the service that counts. It is not uncommon for clients to see compliance-oriented services as commodities, no matter how hard you try to convince them otherwise. For that reason, billing rates for these types of services usually are lower than for other types of services.
Selling Position
Even though a client may view a particular service as a commodity, it is still possible to differentiate your firm from others in ways the client values, for example:

- **Efficiency in service delivery.** In this context efficiency does not mean “cutting the budget so you can compete on cost.” Think of efficiency from the client’s point of view. Does the client have a single point of contact for the project? Do they have to answer questions or provide documents only once? Does your request for information seem logical and streamlined? Can you turn around the work in a short period of time with a minimum of disruption to your client?

- **Thorough and comprehensive.** Your client relies on you to do all the work that needs to be done and to cover the areas that need to be addressed. If you’re preparing a tax return, they want to know that you’ve identified and considered all the deductions possible.

Organizational Infrastructure
Compliance-oriented service offerings will vary in terms of homogeneity. Some services will allow for a kind of “cookie cutter” approach while others will require more customization. But regardless of where these services fall on the spectrum, the basic organizational requirements remain the same.

To deliver compliance-oriented procedures profitably requires a firm to invest heavily in the development of
routines, methodologies, and work programs that will streamline (without cutting corners) the repetitive parts of the process. For example, firms will make big investments in tax preparation software or standardized audit programs (which are then tailored for specific clients).

The ability to share knowledge across the firm plays an important role. When performing compliance-oriented services there is no need to reinvent the wheel. Chances are, someone somewhere in the firm has dealt with the issue before. Best practices have emerged. Firms that do a good job of leveraging knowledge that already resides in-house will have a tremendous competitive advantage over firms that fail to do so.

The Project Team
Compliance-oriented engagements tend to have a formal hierarchy of authority and may have larger project teams. As mentioned previously, billing rates for these types of engagements tend to be lower. Therefore, in order to maintain margins and profitability, firms will need to maintain higher leverage ratios and utilization rates.

Partners on compliance-oriented projects will spend less time “doing” and instead will focus on reviewing the work of others, making judgments about critical issues, and enforcing methodology discipline. Compliance-oriented projects are process driven. Their profitability depends on the firm’s ability to develop an efficient, repeatable service delivery process. It is the responsibility of the project team leaders to see that the process is executed properly.
For example, one of the critical factors in financial statement audit efficiency and effectiveness is setting a proper scope, especially for work related to the evaluation of the client’s internal control. The early engagement in this issue by the audit partner is critical to maintaining profit margins on an audit.

In his lecture, “The Strategies and Management of Professional Service Firms,” Professor Bente R. Lowendahl, observes that individuals who thrive in delivering these kinds of services

- prefer to be in a structured and relatively predictable environment;
- often are perfectionists who like to demonstrate mastery of the subject matter;
- are risk averse; and
- prefer modest and incremental change.

Firms that build successful compliance-oriented practices are those that are able to offer a top-notch learning environment and a structured career path.

**Challenges for Compliance-Oriented Practices**

Firms (or firm practice units) that provide compliance-oriented services will have difficulty winning engagements outside of their established area of expertise. For example, a firm that provides write-up work and basic tax compliance services will be unable to install a mid-range accounting software system even at an existing client. To grow, these types of firms must either
expand their client base to offer the same services to more clients, or

- expand their area of expertise and begin offering new services. Be warned, however, that the delivery of new services may require more than just acquiring expertise. Other changes to the firm may be necessary to make sure its operations are properly aligned with the new service.

Compliance-oriented practices may have difficulty retaining their more entrepreneurial minded staff who are likely to get bored working on the same client, providing the same service year after year.

Problem-Solving Engagements

Problem-solving engagements are the exact opposite of compliance-oriented services. Problem-solving requires you to “go boldly where no man has gone before.” No checklists, work programs, or other road maps exist. What you have is your expertise, creativity and resourcefulness, and a client with a complex problem they may or may not be able to describe.

Indeed, the first step in a problem-solving engagement is to describe for the client the process you will follow to define the problem and explore various solutions. Your initial deliverable is an analysis of the problem and a proposed solution or set of solutions. Actually solving the plan—implementing the chosen solution—is an entirely different phase of the project.
Selling Position
A problem-solving engagement involves a unique and difficult client problem, and because of your expertise, analytical skills, and imagination, you can solve this problem.

The resolution of this problem has significant consequences for your client, and your ability to resolve it provides them with tremendous value. The client regards your expertise and ability to solve problems as unique—no substitutes exist. These engagements should be value billed, not billed on a rate-per-hour basis.

Clients who engage your firm for problem-solving engagements base their decisions on the skills and reputation of the individual expert, not that of the organization as a whole. For that reason, the marketing of these engagements will largely depend on the marketing skills and active involvement of the expert delivering the service.

Organizational Infrastructure
It is essential that your expert maintain his or her level of technical expertise. Developing a national reputation on the subject matter is highly desirable, though not necessarily crucial. For example, if your firm is becoming the expert on tax matters affecting renewable energy companies, you want your experts quoted in the papers, you want their names and faces in the media, and you want their whitepapers circulating in the community.
Compared to compliance-oriented engagements, there is much less need for knowledge sharing across the firm or high realization or leverage ratios. Methodology efficiencies are not as crucial—many times, there is no methodology because the expert must constantly adapt and make it up as they go along. The profitability from a problem-solving project is driven by value billing the expert’s time.

**The Project Team**

Problem-solving engagements are often the work of a single expert who has been given a great deal of autonomy over all aspects of the engagement. The one expert may sometimes use a junior person to help with some narrowly defined aspect of the project, or he or she may collaborate with others who have complementary expertise. But these engagements do not utilize large teams that require substantial coordination and managerial supervision.

Individuals who deliver problem-solving solutions to their clients typically

- are highly individualistic;
- require substantial autonomy;
- possess a unique blend of technical expertise and creativity;
- are comfortable dealing with high levels of ambiguity and forging a new path;
- thrive on new challenges;
■ have a high level of self awareness and self confidence that sometimes crosses the line into unwarranted arrogance; and

■ are not very effective mentors or developers of younger professionals.

Challenges for Problem-Solving Practices
Problem-solving engagements typically are one-off and so it is not easy to ramp up your practice around these types of engagements. Firms that have a preponderance of partners that perform this kind of work will find it difficult to work on compliance-oriented engagements because they won’t have sufficient staff, managerial capacity, or methodologies to perform the engagement profitably.

Problem-solving engagements do not provide the same kind of reliable annuity-type revenue stream that is typical for compliance-oriented solutions. To maintain this kind of practice requires constant communication and marketing to fill the pipeline. It may be difficult to find individuals who are highly skilled at both performing the work and developing new business.

Firms that rely heavily on one-off, special projects are much more vulnerable in an economic downturn than firms that mostly provide compliance-oriented solutions. Elective consulting projects are the first things your clients will cut when times get tough.
Solution-Based Engagements

Solution-based engagements are halfway between a compliance-oriented engagement and a problem-solving engagement. You may think of them as being

- more complex than a common, standard compliance-oriented engagement. For example, it might be an audit of a company that has difficult going-concern issues or that must apply accounting policies in emerging or controversial areas. A solution-based engagement requires much more expertise than pure compliance engagements.

- more structured than a pure solution-based engagement. You are not going where no man has gone before but really to a place very much like the one you’ve already visited.

A solution-based engagement is a semicustom engagement that relies heavily on the expert to configure a solution that can then be implemented by a project team. The sale and installation of an IT solution such as an accounting system is a good example of a solution-based engagement. Some elements of the engagement will be the same from job-to-job and there is an overall work plan. But along the way, the project team will encounter conditions that are unique to the client and that require some type of custom configuration.

Selling Position

Solution-based engagements are a good fit for clients who have a basic understanding of the problem they face but no experience in dealing with it. For example,
they know they need to upgrade their accounting system and have a rough idea of the options available to them, but they don’t know where to begin evaluating their company’s requirements and determining which option is best for them.

These clients are paying for your experience with similar installations. Like the problem-solving solution, these engagements should be value billed. However, keep in mind that your ability to deliver the solution is not unique—other consulting groups sell and install the same software. This lack of uniqueness diminishes the value of your service somewhat.

The firm should position itself as knowledgeable and experienced at providing the solutions being offered. If, for example, you are offering software installations, you should highlight the fact that you have been authorized by the software developer to provide these services.

**Organizational Infrastructure**

To profitably deliver solution-based engagements, your firm must have the ability to collectively capture and share its experiences. Your ability to leverage your methodology and your people can be somewhat limited. What you’re really leveraging is your experience.

For example, if your IT consulting group installed and configured a new auto dealer software package from one office, their experience needs to be communicated to other offices who may have a similar engagement.
It’s also important for you to communicate with others in your firm who are not delivering the same service you do so that those individuals can help drive awareness of the offerings with their clients. For example, the IT consulting group should be communicating regularly with audit and tax professionals who service auto dealerships to make sure they are aware of the IT offerings.

**The Project Team**

Project team leaders have a great deal of experience and technical expertise. Unlike the “lone wolves” who provide problem solving, the leaders of a solution-based engagement also have the ability to mentor and develop younger staff members. They understand that these types of engagements do not rely on leveraging a well-defined methodology so much as they depend on the ability of younger professionals to analyze a situation and make good judgments.

Younger members of the team understand they must perform some routine work to gain the experience necessary to become a project team leader. However, if they feel they are doing too much routine work or their career is stalled, they will become bored and start to look elsewhere.

Solution-based project teams are hierarchical to some extent but not nearly as formal as the compliance-oriented engagement team. On a solution-engagement the relationship between team members tends to be much more collaborative in nature.
Challenges for Solution-Based Practices
Pressure to move toward one end of the spectrum or another is a challenge that firms specializing in solution-based engagements will face. Some in the firm may see an opportunity to drive more volume by adding a more well-defined methodology to the delivery of the service (moving the practice toward a more compliance-oriented approach). The attraction to this movement would be to increase profitability through higher leverage ratios.

On the other hand, project leaders may decide they would be better off if they were to brand themselves by becoming the undisputed subject matter experts in their particular field. Doing so would allow them to deliver services that were more problem-solving in nature. Profitability would come from higher hourly rates or, preferably, value billing.
# Summarizing the Three Types of Engagements

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<th>Problem Solving</th>
<th>Solution</th>
<th>Compliance</th>
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<td>&quot;Boldly go where no man has gone before.&quot;</td>
<td>Unique solutions to complex problems</td>
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<td>Semicustom solutions to known problems</td>
<td>Design and implementation of similar solutions</td>
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<td>Ability to capture and share experience</td>
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<tr>
<td>Compliance</td>
<td>Solution</td>
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<tr>
<td>Project Team</td>
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<tr>
<td>• Formal hierarchy</td>
<td>• Ability to mentor and develop younger</td>
<td>• Individual expert has complete</td>
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<tr>
<td>• High leverage ratios</td>
<td>professionals</td>
<td>autonomy</td>
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<tr>
<td>• Structured and</td>
<td>• Collaborative relationships in a loosely</td>
<td>• Little if any staff; low leverage</td>
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<tr>
<td>predictable environment</td>
<td>hierarchical team</td>
<td>ratio</td>
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<td>• Risk averse</td>
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<td>Challenges</td>
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<td>• Difficult to win jobs</td>
<td>• Will feel pressure to become more of a</td>
<td>• Difficult to “ramp up” practice</td>
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<td>outside area of expertise</td>
<td>compliance-type offering that relies on</td>
<td>because engagements tend to be one-off</td>
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<tr>
<td>• Little chance for value</td>
<td>process and methodology</td>
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<tr>
<td>billing</td>
<td>• Project leaders may want to brand</td>
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<td>themselves and offer problem-solving services.</td>
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Aligning Your Costs and Service Offerings

The nature of your service offerings should drive your cost structure. Once you have an understanding of your services, your next move will be to look at your costs.

The most common overreaction for firms entering a recession is to cut back more than is needed or to cut in the wrong places. Firms that make across the board cuts to all discretionary budget items end up having to spend more to get up to speed when the economy rebounds. For example, time and out-of-pocket costs for laying off and then rehiring to get back up to capacity are significant. Firms will need to balance their short-term and long-term goals.

It’s easy to measure the short-term benefits of cost cutting—whatever you cut falls right to the bottom line. What’s needed then is a way to evaluate the longer-term effects of cost cutting.

To do that, evaluate your cost structure as a whole and assess whether it aligns with your portfolio of service offerings.

Different Service Offerings Require Different Cost Structures

Over the years, your firm has established a pattern of decisions that “determines and reveals the goals of the
firm.”\textsuperscript{16} For example, your firm may have decided to perform only financial statement reviews, compilations and write-up work but no audits. Or it may have ceased doing work of any kind for state and local governments. Or perhaps it has invested heavily in building up a forensic accounting practice. Whether you realize it or not, your firm has defined its service offerings.

What about its cost structure? Is it aligned with your service offerings? Are decisions relating to personnel, compensation structure or IT investments consistent with and supportive of the services you offer your clients?

Decisions about the actions you will take in response to the current economic downturn should be evaluated within the overall context of alignment. Given a variety of choices, ask yourself “which one will help us better align our service offerings and cost structure?” Answering this question will help you make more effective decisions about how your firm will respond to the current economic conditions.

For example, consider two firms, A and B. Both firms have five partners and bill about $5 million annually. Partner compensation at each firm ranges from $250,000–$300,000. Both firms operate in the same geographic area of the country.

But significant differences do exist in the service offerings of the two firms, as summarized in the following table (p. 55):

### Firm A vs. Firm B

<table>
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<tr>
<th>Firm A</th>
<th>Firm B</th>
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<tr>
<td>40% of firm revenues derived from its business valuation and IT consulting practices. These engagements are nonrecurring in nature.</td>
<td>Performs very little consulting or special projects work. Most of the firm revenue is derived from recurring clients and engagements.</td>
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<td>A significant portion of the firm’s tax practice is transactional tax planning related to M&amp;A activity. These clients generally do not engage the firm to perform other services.</td>
<td>Tax practice consists exclusively of routine tax compliance and planning services for individuals and small businesses. Most tax clients engage the firm for other services such as financial statement reviews.</td>
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<td>Nearly half of the firm’s A&amp;A practice is comprised of nonattest special projects performed for clients of larger firms who can not engage the other firm due to independence rules.</td>
<td>A&amp;A practice includes nonattest engagements, but these are limited to write-up and bookkeeping services.</td>
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These two firms are more different than alike. You would expect these practice differences to be reflected in key operational strategies such as the following:

- Communications and marketing
- Leverage ratios
- Billing rates
- Compensation
- Competencies and skill sets of firm personnel
- IT systems

Alignment simply means that these and other operational areas should make sense given the firm’s service
offerings. Put another way, you wouldn’t expect firm A to do very well if its operations were designed to deliver the services firm B offers to its clients. And vice versa.

**Map the Shape of Your Firm**

Sometimes it helps to visualize a situation. The following graph illustrates how firm A and firm B differ.

![Graph illustrating the shape of firms A and B](image)

The horizontal axis shows the continuum of service types, ranging from compliance-orientation at the far left, to problem-solving on the right. The vertical axis represents revenue. Within this domain we can plot the practice profiles of the two firms. Underneath the graph, we have summarized the main profit drivers, leverage, utilization, and billing rates to get a more complete picture of the firms.

We now see that firm A offers mainly semicustom solutions to its clients that require a high-level of expertise and virtually no basic, compliance services. Profitability depends on being able to realize higher billing rates
The Short Term

and value billing. Their leverage ratios will be lower than average.

Firm B plays at the other end of the spectrum, offering mostly compliance-oriented services. Their profitability depends on higher leverage and utilization ratios. Their billing rates will be lower so, in order to maintain their margins, they must continually make their service delivery more efficient.

Changes in the Shape of Your Service Offering Curve

The “shape” of your service offering curve is not static. As you add new services, pick up new clients, or lose old ones, the curve will flatten out or lengthen, the apex may rise or fall. Changes in the business environment can shift the location of the curve along the horizontal axis. When cost structures do not shift accordingly, your firm becomes misaligned.

For example, suppose firm B—which is primarily a compliance-oriented practice—lands one or two problem-solving engagements. In this situation, the most common problem is a failure to value bill the engagement. The partner who brought in the client and who most likely will be performing the bulk of the work will not be able to leverage lower-priced staff and, without increasing his or her own billing rates, the margins on the job will be less than margins on their more typical compliance engagements.
Typically, you will see a leftward drift of the curve over time. That is, what starts out as a highly valued problem-solving service can become a simple compliance engagement as the novelty of the work wears off and a body of knowledge and practice tools begin to develop.

The most recent example of this is Sarbanes-Oxley Act Section 404 consulting engagements. In 2003, when the Sarbanes-Oxley Act internal control requirements first became effective, corporate management needed help documenting and testing their company’s internal control. This was uncharted territory. CPA firms that performed this work had to figure it out as they went along. On the first few engagements, partners did most or all of the work, performing systems walkthroughs, writing memos and drawing flowcharts, and preparing working papers.

Once the partners understood the basic requirements of the engagement, they could pass along their knowledge and experience to less senior professionals. Standard work programs were developed. Internal control documentation software was introduced into the marketplace and slowly adopted. Now, for many companies the testing and documentation of internal control is routine, and the firms that assist these clients are doing compliance-oriented work, which is staffed and priced accordingly.

Other external forces that can affect the shape of your product offering curve include the following:

- Clients move the work in-house. As the nature of the marketplace shifts, demand for the service also may
shift. In the case of Sarbanes-Oxley Act engagements, as the work became more routine, companies had the resources in-house to do the work and so they no longer had the need to outsource it.

- **Market saturation.** It’s possible that the demand for a particular problem solving service simply dries up because all those who face the problem eventually solve it. For example, a firm that offers niche consulting services to a narrowly defined industry segment may reach a point where it has performed engagements for all of the main targets in the industry.

- **One-time-only opportunity.** The most recent example of the one-time-only opportunity was Year 2000 (Y2K) consulting. Once we entered the twenty-first century, the need for the service became nonexistent.

**Your Infrastructure Should Accommodate Change**

This natural leftward drift combined with other external forces means firms that place themselves at the right end of the spectrum must be on the constant lookout not only for new clients but also for new client needs upon which they can develop services. Thus, these firms must be “cutting edge,” constantly scanning the landscape and looking for opportunities. For these firms, tremendous advantage exists in being first to market. You want to get in before the “leftward drift” starts, while the service can still be value billed.
Firms that sit at the left end of the spectrum are not affected nearly as much by external forces. They can only drift so far left. The services they perform have stood the test of time and generally are recession-proof. “Death and taxes,” after all.

Firms on the left don’t have to look for new services to offer; they just have to monitor external changes that affect their existing services; for example, a new accounting pronouncement or tax law. The pressure to find new clients is diminished and they can focus on retaining existing clients. Growth strategies can be built around attracting new clients and, better yet, new clients in growth industries.

All CPA firms have a need to communicate and reach out regularly to their clients and prospective clients. But the messaging and firm positioning for firms on the left will be different from firms on the right end of the spectrum.

The marketing needs will be less demanding for firms that perform compliance-oriented services. Instead, firms on the left will thrive by focusing their attention on process and methodology improvements that drive efficiency and increase margin.

Understanding the nature of your service offering and the “shape” of your firm’s offerings is a good first step to making the adjustments necessary to position your firm to move into the new, post-recession economy. Compare your operations and cost structure to your service
offerings to identify opportunities to bring these two into closer alignment.

Deciding Where to Invest and Where to Cut

Staffing and Compensation
Compensation is the single biggest expense in a professional services firm. In general, compensation expenses at a CPA firm are 30 percent to 35 percent of gross billings, so it is natural for firms to look for ways to cut compensation expenses.

A detailed discussion of staffing and compensation is beyond the scope of this book, but it is worth noting some of the trends that have begun to emerge just in the short time that firms have been forced to make staffing decisions:

- Reductions in head count generally have been limited to those involved in special projects where demand has fallen off and the backlog of projects is negligible. Firms that live at the left end of the service offering spectrum have seen very little reduction in staff.
- Firms that have had to lay off staff have made significant outlays for outplacement services.
- Raises have been reduced and in some cases, eliminated.
Firm matching of employee 401(k) contributions have been reduced or eliminated. Firms have found creative ways to offer reduced work hours in exchange for reduced compensation. One law firm recently made headlines when they offered to give their associates an entire year off while paying them one-third of their salary.17

Other Expenses
Other expenses such as occupancy costs, marketing and IT typically comprise another 30 percent to 35 percent of gross billings. Your decisions about these costs will depend on where you want to position your firm on the service offering spectrum. You should consider not only your position today, but also where you want to be positioned when the recovery begins. Be sure to keep in mind the “leftward drift” and other external factors that will affect your position.

Using the principle of alignment, the table on the following page provides some general guidance on those areas where you should continue to invest and those costs you may be able to defer.

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<th>Left Side of the Spectrum</th>
<th>Right Side of the Spectrum</th>
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<td>Keep investing in...</td>
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<td>• Technology to improve</td>
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<td>Think about deferring...</td>
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<td>• New business development</td>
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<td>• General IT upgrades</td>
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<td>specific tools and practice</td>
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Depending on the size and complexity of your firm, it may not be appropriate for you to make firm-wide, across-the-board decisions about costs. For example separate decisions may need to be made for the consulting practice, tax, and accounting and auditing practices depending on the nature of their service offerings.
Where Will Next Year’s Revenue Come From?

Firms that have lost clients during the recession will feel pressure to replace lost fees. Even if your firm has not lost clients, you should not assume that the next year will be the same as the last. Even compliance-oriented firms must recognize that there will be some attrition in their client base from year-to-year. Recognize that all firms are under some pressure to find new sources of revenue in the upcoming year.

For example, suppose your firm billed $1 million in fees last year. A good portion of that revenue was from clients and engagements that will carry forward into the current year, but some of last year’s engagement will not be repeated in the current year, so you must plan on generating new business just to stay even.

Even if 90 percent of your revenue comes from repeat engagements, your $1 million practice must generate $100,000 of new work each year simply to maintain the status quo. If costs rise by 10 percent, that’s additional new work to generate.

For the past 5 or more years, most firms have been able to generate revenue from new sources simply by answering the phone. At the other end of the phone line was a new client or an existing client needing new services. An entire generation of young partners has grown up in this type of business environment.
In the current recession and early stages of recovery, faith in the “answer the phone” approach will be severely tested. A more disciplined approach will be needed to plan for acquiring new business.

Key metrics such as margin, realization, utilization, and leverage are useful for tracking and monitoring the firm’s financial performance. However, that model is ill-suited for developing a plan to generate new business. For example, leverage drives partner profitability, but hiring more professionals to increase your leverage is not a growth strategy.

As you begin to position your firm for growth in the post-recession economy, instead of tracking the drivers of revenue, you would be better served to track the sources of revenue.

**Sources for Revenue Growth**

Five main sources of revenue exist, as summarized in the box on the following page.

---

18 This subsection was adapted from “Take Command of Your Growth,” by Michael Treacy and Jim Sims, originally published in *Harvard Business Review*, April 2004.
### Source of Revenue

**Revenue from Core Business**
- **Base retention**: Continue to provide services to existing clients.
- **Share gain**: Engagements won from peer firms.
- **Expanding client demand**: Increased fees from existing clients.

**Revenue from New Business**
- **Adjacent market revenue**: Revenue from core services that you provide to new clients.
- **New lines of business**: New service offerings to new or existing clients.

Using these sources of revenue, you can create a revenue projection for the current and future years.

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td><strong>Prior year revenue</strong></td>
<td>$ XXX</td>
</tr>
<tr>
<td><strong>Less: lost clients/fees</strong></td>
<td>(X)</td>
</tr>
<tr>
<td><strong>Base retention revenue</strong></td>
<td>XXX</td>
</tr>
<tr>
<td>Core revenue sources</td>
<td></td>
</tr>
<tr>
<td><strong>Share gain</strong></td>
<td>X</td>
</tr>
<tr>
<td><strong>Expanding client demand</strong></td>
<td>X</td>
</tr>
<tr>
<td>New business sources</td>
<td></td>
</tr>
<tr>
<td><strong>Adjacent market revenue</strong></td>
<td>X</td>
</tr>
<tr>
<td><strong>New lines of business</strong></td>
<td>X</td>
</tr>
<tr>
<td><strong>Current period growth</strong></td>
<td>XX</td>
</tr>
<tr>
<td>(a)</td>
<td></td>
</tr>
<tr>
<td>(b)</td>
<td></td>
</tr>
<tr>
<td>(a)+(b)</td>
<td></td>
</tr>
<tr>
<td><strong>Projected current period revenue</strong></td>
<td>$ XXX</td>
</tr>
</tbody>
</table>
Analyzing the Revenue Projection

To create a comprehensive plan for business and revenue growth, start with the revenue projection model described previously and work through each of its components.

Lost Fees

Your estimate of lost fees is a critical first step because it allows you to determine your base retention revenue for the year. Start this estimate using a “specific identification” method. That is, have each of your partners review his or her clients and identify lost clients and those for which current year’s fees will decrease. Factor in the fees from those clients the firm has decided to terminate.

Also, you should make an allowance for unexpected lost clients and revenue. In making that estimate, consider the following:

- Your firm’s historical experience with client turnover.
- Current conditions and trends in your clients’ industry or the local economy. Is there a lot of consolidation in the industry? Are companies delaying their purchase of consulting projects of the kind your firm provides?
- The nature of your firm’s practice. For example, do you have multiyear contracts that are up for renewal in the current year?
- Your client retention strategy. Do you plan to take aggressive action to protect your base revenue? For example, how aggressively will you pursue that multiyear contract that goes out for bid this year?

(cont.)
To recap:

\[
\text{Lost fees = (specifically identified lost fees) + (estimate for unanticipated losses)}
\]

Subtract your total estimated lost fees from prior year’s revenue to arrive at your Base Retention Revenue. This is the starting point for building your new business strategy for the future.

Share Gain Revenue

This variable represents fees you will gain by outcompeting your peer firms. For example, suppose that your main competitor has a multiyear contract that expires and will go out to bid in the current year. How aggressively will you pursue that work? This variable is the flip side of your analysis of your own firm’s expected client and fee loss. What do you expect client turnover to be at your peer firms? What are your plans for going after the clients your competitors will lose?

What are your competitors’ vulnerabilities and how might you use them to your advantage to drive up their turnover rate? For example, suppose you believe one of your competitors overreacted to the recession and reduced head count too much in its state and local government practice. What opportunity for growth in that practice area does that move create for you? What is your strategy for capitalizing on that opportunity?
Core Revenue Sources—Expanding Client Demand

This topic considers how changes to your clients’ business or their business environment can expand the demand for your firm’s services. Sources of increased client demand may come from the following:

- **Organic growth of your client’s business.** Some industries such as renewable energy and electronic medical records have been targeted for growth by the current administration. Some of your clients may operate in “recession proof” industries, and they will continue to grow. As your clients grow, the demand for your services also should grow. For example, owners of successful companies eventually need estate planning services; companies that become an acquisition target of a non-U.S. subsidiary will need help converting their U.S. generally accepted accounting principles (GAAP)-based financial statement to International Financial Reporting Standards.

- **Sudden, unexpected change.** The breadth and depth of this recession and the speed with which it proceeded caught many companies by surprise. The resulting fallout may create demand for CPA firm services. For example, banks that received Troubled Asset Relief Program funding need help complying with the increased financial and nonfinancial reporting requirements.

- **New mandates.** Changes to existing laws or regulatory requirements can significantly increase your clients’ demand for your firm’s services. The tax law changes in the American Recovery and Reinvestment Act (ARRA...
or stimulus bill) and the budget will be important opportunities for most CPA firms to provide more services to their current clients.

New Revenue Sources—Adjacent Market Revenue

Many firms have been successful by expanding their core service offering to new locations, new industries, or new products. For example, a firm will open a new office in a submarket of the city in which it operates. Other firms have pursued a strategy of expanding their services to closely related industries in which they already operate. For example, some firms have banking and real estate clients that share a common set of accounting and auditing issues. Other firms have created synergies from their not-for-profit and state and local governments practices that must comply with the Single Audit requirements.

The key to pursuing this strategy is the careful consideration of what you consider “adjacent.” To minimize your risk, you will want to expand into areas that allow you to leverage your firm’s established strengths. For geographic expansion, physical proximity will be a primary concern. The expansion can’t be too close to your current operations, otherwise you begin to cannibalize your existing base, building the new practice at the expense of the existing one. But if the new location is too far, you may not be able to leverage existing resource. For example, are the offices close enough that your staff can work engagements based out of either one?

For expansion into new specialized industries or products, the key consideration will be your firm’s ability to leverage the
skills and knowledge of its existing personnel, and the methodology and tools available for service delivery. For example, someone who audits banks probably will be familiar with asset valuation issues (including real estate valuation), which is a necessary skill for auditing a real estate investment or development partnership. A firm that installs midrange accounting software packages may be well-suited to offer installations of low-end accounting software.

New Revenue Sources—New Lines of Business

Growth from new lines of business entails providing new services to new or existing clients. Recognize that it is very difficult to drive demand for a new service “out of thin air.” For example, many years ago, some firms launched “Elder Care,” a service that was designed to provide bookkeeping and financial support services to the elderly. In theory, the service made sense; demographic shifts indicated that the number of elderly Americans was growing, and the need for the services seemed apparent. A great deal of time and effort was spent defining the service, and firms that launched it spent resources to promote it. But at the end of the day, the demand for the service simply didn’t exist, and today you would be hard pressed to find any CPA firm that offers “Elder Care.”

If your firm adopts a strategy of growth from new lines of business, then demand for the new service must already exist. Alternatively, the demand for the new service must be driven by larger business trends or shifts in public policy.

(cont.)
Growth from new lines of business may come from
- acquiring an existing practice, for example through acquisition of another firm, or the hiring of a new partner. To begin offering forensic accounting services, you may hire a partner who already has a forensic accounting practice.
- developing in-house expertise to deliver a service for which demand already exists. For example, your firm may decide to begin offering business valuation consulting services by having one of your partners trained and credentialed in the discipline.
- responding to changes in laws or regulations. The passage of the Sarbanes-Oxley Act allowed many firms to successfully launch consulting services built around compliance with the Sarbanes-Oxley Act. Prior to the passage of the law, these services did not exist.

Tips for Estimating Growth
Estimating growth from the various sources is hardly an exact science. The idea here is not necessarily to “hit the number,” but to discipline your thinking about your strategy for the coming year and develop an actionable plan. To achieve these objectives, you will want to be as specific as possible about the engagements you will pursue and your chances for success.

For example, suppose that—for a variety of reasons—one of your peer firms has decided it no longer will perform audits. You estimate the size of their audit practice to be $150,000 to $200,000. Rather than make a blanket assump-
tion like “we’ll probably pick up half the work,” build your estimate from the bottom up by targeting specific clients:

- Which specific engagements are you going to target?
- How will you get access to the decision maker?
- What other firms will go after the work?
- How will you differentiate yourself?
- What are your chances of getting the engagement?

Only by answering these and other probing questions will you be able to develop an actionable plan for generating new business.

Plan for New Business

A CPA firm must constantly seek new business just to survive. This need for growth can not be ignored during a recession. In fact, you must make an even greater effort to find and attract new business.

Basketball coaching legend John Wooden had a saying: “Failing to plan is planning to fail.”

Setting a strategy for firm growth does not guarantee that your firm will grow. But failing to set a strategy (the “answer the phone” approach) limits your chance for success.

This next section presents a case study in how a CPA firm might apply fundamental growth strategy principles to manage their firm’s business development and plan for growth in the upcoming year.
Planning for Revenue Growth: A Case Study

The firm Titcomb, Behr, and Gregg (TBG) operates in Los Angeles with one office in Century City. The firm has audit, tax, and consulting practices with its expertise concentrated in real estate and hospitality, high-wealth and highly-compensated individuals, and privately-held commercial entities.

Key operating statistics for TBG at the end of their most recent fiscal year are as follows.

<table>
<thead>
<tr>
<th>Personnel</th>
<th>Partners</th>
<th>12</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Professional staff</td>
<td>80</td>
</tr>
<tr>
<td></td>
<td>Leverage</td>
<td>6:7:1</td>
</tr>
<tr>
<td>Revenue</td>
<td>Audit and Accounting</td>
<td>$4,298</td>
</tr>
<tr>
<td></td>
<td>Tax</td>
<td>$8,595</td>
</tr>
<tr>
<td></td>
<td>Consulting</td>
<td>$2,507</td>
</tr>
<tr>
<td></td>
<td>Total Revenues</td>
<td>$15,400</td>
</tr>
<tr>
<td>Billing Rates</td>
<td>Partner</td>
<td>$200</td>
</tr>
<tr>
<td></td>
<td>Managers (6–10 yrs.)</td>
<td>$160</td>
</tr>
<tr>
<td></td>
<td>Sr. Associates (4–5 yrs.)</td>
<td>$125</td>
</tr>
<tr>
<td></td>
<td>Associates (1–3 yrs.)</td>
<td>$100</td>
</tr>
<tr>
<td>Other</td>
<td>Average margin</td>
<td>30%</td>
</tr>
<tr>
<td></td>
<td>Revenue per professional</td>
<td>$220</td>
</tr>
<tr>
<td></td>
<td>Average staff utilization</td>
<td>70%</td>
</tr>
</tbody>
</table>
Creating TBG’s Growth Strategy

Over the past 3 years, the firm has averaged 12 percent to 15 percent annual growth in fee revenue. Because of the current year recession, they do not expect to do as well this year. To develop the firm’s growth plan for the future, the partners analyzed each revenue source and noted the following.

Lost Clients/Fees

- At the current time, the firm is not aware of any audit clients it has lost. However, it has identified several underperforming clients it will terminate. Gross fees from those clients were about $150,000 during the past year. Historically, the firm has had very little turnover, but this year they expect to lose some work due to the recession, so they made a conservative, ballpark estimate of a 5 percent loss.

- A good percentage of the firm’s tax work is on one-time projects, and year-to-year they typically retain 75 percent of the fees generated in the prior year. Last year, other peer group firms raised their billing rates 10 percent, but TBG did not. For the current year, they plan a 7 percent across the board increase, which they feel the market will bear.

- Very little of the firm’s consulting work is from continuing engagements. Most of the work comes from litigation support and business valuation, which is not recurring in nature. As of the end of the fiscal year, the company had several engagements slated
to begin in the first quarter. Estimated fees from these engagements are $850,000.

**Share Gain**

- One of the firm’s clients is a general partner in several real estate development limited partnerships. Currently, TBG is one of two firms that audit the partnerships, and the client has stated that it wants to work with just one audit firm. TBG already audits five of the seven partnerships and of the two firms, it enjoys the stronger relationship with the client. The partner of the other firm has hinted that they will not aggressively pursue the client.

- For the past few years, one of the firm’s tax clients in the entertainment industry has been an excellent referral source. Because of these referrals, the firm has established a growing niche in tax and estate planning services for high wealth/high income individuals in the entertainment industry. This growing practice has fueled the growth of the firm’s tax practice, and the partners expect that trend to continue.

**Expanding Demand From Existing Clients**

- Historically, the firm has been able to expand its audit practice by “answering the phone.” Its clients were in growth industries, and the demand for the firm’s audit and accounting services grew along with its clients’ business. The introduction of new accounting and auditing rules also drove some of the audit and accounting department’s growth. In the past two years, increased demand has accounted
for annual growth of 20 percent. For the current year, most of the firms’ larger clients are not expected to grow that much, and no GAAP or generally accepted auditing standards (GAAS) changes exist that have a wide impact. The partners believe that increased work from existing clients will make up for any lost clients, though at this point, they have no definite plan for making that happen.

- Recently enacted and proposed tax law changes will have a significant impact on the firm’s tax clients, and the firm expects to be able to generate significant business helping clients respond to and comply with these changes.

- The firm’s IT consulting practice has grown steadily over the past several years. The consulting partners feel confident that their practice will not contract during the year and that they will retain the overall revenue levels.

**New Growth**

- The firm has an established tax practice in the entertainment industry and they are well known for their litigation support work. However, they have never had the chance to combine these two practices and perform a litigation support engagement in the entertainment industry. In the coming year, several large disputes between studios and their actors, writers, or directors are expected to emerge. The firm plans to pursue these opportunities aggressively, and the consulting partners have included a
conservative estimate of the fees that could result from being involved in just one of the disputes.

- Because the firm has cut back on its resources, it has no other plans for expansion into new business areas.

Projections and Analysis

Based on these discussions with its partners, the firm’s projected revenue for the current year are as follows:

<table>
<thead>
<tr>
<th></th>
<th>Audit</th>
<th>Tax</th>
<th>Consulting</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prior Year revenue</td>
<td>$4,298</td>
<td>$8,595</td>
<td>$2,507</td>
<td>$15,400</td>
</tr>
<tr>
<td>Lost clients/fees</td>
<td>$(450)</td>
<td>$(1,150)</td>
<td>$(2,100)</td>
<td>$(3,700)</td>
</tr>
<tr>
<td>Backlog</td>
<td>$0</td>
<td>$0</td>
<td>$850</td>
<td>$850</td>
</tr>
<tr>
<td>Base retention revenue</td>
<td>$3,848</td>
<td>$7,445</td>
<td>$1,257</td>
<td>$12,550</td>
</tr>
</tbody>
</table>

Growth sources

| Core growth: share gain   | $100   | $650   | $150       | $900    |
| Core growth: expanding demand | $450 | $1,500 | $1,000     | $2,950  |
| New growth: adjacent markets | $0    | $0     | $200       | $200    |
| New growth: new line of business | $0    | $0     | $0         | $0      |
| Projected current year growth | $550 | $2,150 | $1,350     | $4,050  |
| Projected current year revenue | $4,398 | $9,595 | $2,607     | $16,600 |
Understanding the Growth Strategy

Looking at the firm’s projections and understanding the underlying assumptions, you begin to understand the company’s strategy for managing its top-line in the current year. Keys to that strategy are as follows:

 Audit and tax.

- Prevent slippage of base revenue. The partners have included some conservative assumptions about the clients they will be able to retain, but given the current economy the audit partners will have to closely monitor client relationships to retain as much of their base revenue as possible.

 Audit.

- One of the firm’s real estate development clients may be seeking a new auditor for some of its partnerships, and TBG plans to make a strong bid for the work.
- The growth from existing clients is an “answer the phone” strategy. If the phone doesn’t start ringing soon, a more definitive strategy will need to be developed.

 Tax.

- Tax department success depends on (1) pushing through the 7 percent across the board fee increases, (2) continued expansion of its entertainment industry practice, and (3) performing significant work related to the new tax law changes. Communication and marketing plans must be developed to support each of these initiatives.
Consulting.

- The bulk of the current year’s revenues will depend on how successful the firm is in its IT consulting practice. Right now, the details of this plan are sketchy—the partners have based their estimate on recent trends. The partners should closely monitor the amount of work they have in the pipeline, and if that starts to drop significantly, then a more definitive strategy will have to be developed.

- New business is expected to result from litigation support in the entertainment industry. To improve their chances of getting this work, the practice needs a more definitive communications plan to reach out to key players.
Part 3:
Investing for the Long-Term
Shifts in public policy are creating opportunities for new business, not just now but well into the future. Forward-looking firms that have a deep understanding of how these shifts affect their clients should take advantage of the current conditions to invest for the future.

In their article, “Seize Advantage in a Downturn,” David Rhodes and Daniel Stelter make the case for making those investments now.

“Investments made today in areas such as product development...will, in many cases, bear fruit only after the recession is past. Waiting to move forward with such investments may compromise your ability to capitalize on opportunities when the economy rebounds. And the cost of those investments will be lower now, as competition of resources slackens.”

This section lays out an approach for building your practice around some of the new opportunities that will arise from our current shifts in public policy. The two segments discuss

- building a growth platform that will help create a self-sustaining business practice rather than one built on one-off projects.
- taking advantage of some of the specific new business opportunities available in the post-recession economy.

Building a Platform for Future Growth

In the midst of a recession it’s easy—and sometimes necessary—to accept whatever work you’re presented with. Certainly, it’s critical that you continue to generate sufficient revenue in the short term, but you also need to strike the right balance between these short-term imperatives and your long-term strategies. Ideally, you will want to take on work in the short-term that is not a one-off opportunity, but rather is the first step toward building a platform for future growth.

For example, you may have the opportunity to provide tax planning services to a business owner who is interested in understanding and taking advantage of the energy tax credits proposed by the new administration. You may decide to take on the new client and do all the necessary research and treat the work as a one-time opportunity. A better result would be to take the project and find a way to generate work in the future by leveraging

- your new found *expertise and knowledge* into a new service offering, and
- your new *client relationship* by providing additional services to this business owner and her referrals.

---

20 Temper though it may be, when taking on new work during a recession, try to avoid the following:

- Difficult or demanding clients
- Projects that reduce your margins or otherwise put you into an unsustainable fee arrangement
- Projects that require you to develop an expertise, build relationships, or create intellectual property that has limited future value.
Leveraging Expertise and Client Relationships

The figure shown here illustrates how you might consider these expertise and client relationships when building a platform for future growth. The diagram plots your existing and potential clients along one axis and your current and planned service offerings along another. The resulting grid can be split into four quadrants, which correlate to the four revenue growth sources introduced in the previous section.

Beginning with your base, you can expand initially in three different directions to create a growth platform for the future.
Leveraging Your Existing Service Offering

One strategy would be to use your existing expertise as a platform to attract new clients. That is, you would expand horizontally from your base. Those new clients can then serve as a source of additional revenue once recovery begins.

For example, suppose your firm provides tax compliance and planning services to high-wealth individuals (in the current recession, probably not as high-wealth as they used to be). During the recession, you may find opportunities to offer those services to new clients. For example, suppose your firm establishes itself as the thought leader on the tax law changes contained in the American Recovery and Reinvestment Act (ARRA) and how these changes affect high-wealth individuals. As the recognized thought leader, you are well positioned to pursue the clients of peer firms who have been slow to respond to the tax law changes.

These new client relationships then become a platform for you to provide additional services once recovery begins. Suppose that your high wealth tax practice is concentrated in the software industry. During the recession you gained new clients in the real estate industry. Once recovery begins, those real estate clients will need other services that you already provide, such as audits of limited partnerships. Thus, by leveraging your current service offering to attract new clients, you create an expanded client base to deliver other service offerings.
This strategy is particularly well-suited for those firms who have a clearly defined, profitable service offering and who have broadly positioned their brand around this expertise.

This next figure illustrates this strategy.

![Diagram](image)

**Leveraging Your Existing Client Base**

A second strategy would be to use your existing client base as a way to gain new knowledge and pilot test new service offerings. That is, move vertically from your base. Once you more fully define the service offering and develop the expertise and tools required to deliver it profitably, you can then expand to provide the same service to new clients.

For example, suppose your firm has a strong presence serving state and local governments. Some of your clients will
be recipients of ARRA funds, which will dramatically increase their reporting requirements, putting a strain on their accounting system and their internal controls. You see that these clients need your help, but you aren’t sure exactly how you would define the engagement and make it profitable.

Why not pick a client to beta test your service offering? Lower your fees. The expectation is that the beta test will give you the chance to more explicitly define the service offering, understand what it takes to deliver it profitability, and develop the skills and tools necessary to roll out the service broadly. What you have “bought” with your lower fees is not a future revenue stream from this client, but rather you’ve invested in building a growth platform that will allow you to create revenue streams from an entire group of clients in the future.

This strategy works well for firms who have built their brand around specialized industry expertise and who have relationships of trust with at least one client that is progressive and willing to work with you on your beta test.
New Services, New Clients

A third strategy would be to launch an entirely new service offering. That is, move diagonally from your base.

For example, suppose that your best friend is a partner with another firm. She has not been happy there for several years, and the recession has made her situation even worse. She is an IT consultant who sells and installs midrange accounting systems. She has a backlog of four months of work.

Your firm does not have a separate consulting group. Now would be a perfect time to start one by bringing your friend on board. The recession has created a unique opportunity that may not come along again. The timing is perfect. Her backlog means that the other partners will not have to subsidize her while she builds her practice.
By bringing her over to your firm, you position yourself for post-recession growth. Not only will she be able to provide her service to new clients, she also will be able to target your existing client base.

The following figure illustrates this strategy:

![Diagram](attachment:diagram.png)

**Communication and Marketing Strategies**

A large part of the success of your business development efforts will rest with your communication and marketing efforts. A detailed discussion of communication and marketing is beyond the scope of this book. What follows is a brief summary of key communication and marketing concepts that will help you implement the suggestions contained in Part 2 of this book.
Communications vs. Marketing

Communications is the ongoing dialogue you have with your clients and prospective clients. Your communications efforts include many activities that are pure outreach and have nothing at all to do with trying to sell your clients your services. For example, posting an article on your Web site or publishing it in your client newsletter about the latest tax law developments from Washington is part of an overall communication effort that may not be directly related to selling your clients tax preparation services. You put the article out there because you think the information will be valuable to your clients.

Marketing is a subset of communication. Marketing is a focused communication effort where you try to drive your client to take definitive action: purchase our services. Where communication is an ongoing process, marketing is composed of discreet campaigns with a beginning, middle, and end. Once the client signs up for the service, the need to continue marketing that service to that client no longer exists. But you will always have a need to communicate with that client.

Developing and Executing a Marketing and Communications (Marcom) Plan

A well-thought out marketing and communications plan will help ensure the success of your firm’s business development efforts. Documenting your marcom plan is important because
- the process of documenting something forces you to more clearly understand what it is you’re trying to say. Being required to document something will drive discipline into your thought process.
- a documented plan allows you to share it easily with others.
- a documented plan makes it easy to compare your actual results with what you expected you would be able to achieve.

The following diagram provides an overview of what’s required to develop and execute an effective marcom plan. The diagram shows three key inputs to the plan: the firm’s brand, its business development strategies, and other elements of the firm’s business.
From these three inputs you can create a plan that defines your message, the target audience, and how you will deliver that message to your target. This overall marcom plan then must be built out in more tactical detail by providing specific goals and deliverables for both the communication and the marketing pieces. Finally, you need some marketing resources to execute your plan.

The development of an effective marcom plan requires you to have a clear understanding of the following:

- Your firm’s brand
- Your business development strategies
- Key elements of your firm’s business

Having a clear understanding of these items is a prerequisite to any marcom plan.

**Brand**

Your firm’s brand is a distilled version of your company’s mission, vision, and values. Consider for a moment some of the world’s top brands:

- Google
- Apple
- Toyota
- American Express

If you’re like most people, when you see those brands you attach a set of subjective attributes to that brand, and these attributes help differentiate that company from others they compete against. An Apple computer is much different from a Dell computer, for example;
an iPod is different from a Zune. People feel differently about American Express than they do about MasterCard or Visa.

For the purposes of developing a marcom plan and generating new business, having a clear understanding of your firm’s brand attributes is absolutely critical. All messaging flows from your brand and must be consistent with your brand. For example, the American Express brand projects an aura of exclusivity, whereas MasterCard positions itself as a card for everyone. The American Express tagline—“Membership has its Rewards”—is consistent with its brand, and MasterCard’s is consistent with its brand. (“There are some things money can’t buy. For everything else, there’s MasterCard.”)

Brand allows you to position yourself against your competition. Look at how MasterCard positions itself against American Express, or Avis against Hertz, or the Mac against the PC. You should be able to position your firm against your competition in a similar way.

**Business Development Strategies**

Your marcom plan must be tightly integrated with your firm’s longer-term business plan. For example, consider the growth strategy illustrated on page 91, where the firm plans to offer a new service to some existing clients. Once they successfully offer the service to an existing client, they will then begin offering that service to new clients.
The marcom plan must be built around this overall strategy, which will determine the most critical elements of the plan, as described in the next section.

The Marcom Plan
Your marcom plan should provide broad answers to the following.

- **Target.** Who are you targeting with your communication and marketing? Why? What are the key characteristics of this group of clients or prospects?
- **Message.** What attributes do your targets attach to your brand? What messages can you build around those attributes that will resonate with your targeted group?
- **Delivery.** What is the most effective and efficient way to deliver the message to the target, for example, an article on the firm’s Web site or newsletter, a firm-sponsored webcast, a personal call or in-person meeting with the client service partner?

Execution

**Tactical Details—Ongoing Communication**
The marcom plan is a broad outline. Your next step will be to add tactical details that can be executed to put your plan in action. Critical to this process is having a clearly defined goal for your communication plan. When setting this goal consider the following:

- **Brand.** Every time you interact with your clients you are reinforcing your brand attributes. The key is to
reinforce the attributes you want people to attach to your firm and eliminate any attributes that dilute your overall brand. In that sense, one of the goals of your communication plan will be to support and reinforce your firm’s brand.

- **Building a foundation for marketing campaigns.** Your marketing campaigns are a natural outgrowth of your communication plan, so you should use your communication plan to build broad awareness of the services you offer and current developments in your areas of expertise.

For example, consider the firm that has an existing practice focused on entrepreneurial and emerging businesses. The firm is considering ways to expand its practice by targeting companies in the renewable energy industry. The firm has no clients in this industry but has taken some initial steps to connect with business owners in the industry because they believe it is a potentially high-growth industry.

Even before this firm begins its first marketing campaign (for example, developing a brochure and sending it to prospects) it needs to implement an overall communication strategy that addresses the following elements:

- **Firm brand and positioning.** In this case, the firm will want to position itself as the experts in helping entrepreneurs achieve their business goals.

- **Key messages and supporting details.** For your audience to “get it” you have to repeat the same message over and over. Limit your communication
plan to 2 or 3 key messages, and then support those messages with additional details. See the example below.

<table>
<thead>
<tr>
<th>Key Message</th>
<th>Supporting Messages</th>
</tr>
</thead>
<tbody>
<tr>
<td>We are experts in helping emerging businesses</td>
<td>Over the past XX years we have worked with YY clients in high growth industries such as a, b, and c. We help entrepreneurs in a wide range of areas, including business tax planning, financial statement preparation, securing access to funding, etc. Our partners have a combined XX years of serving</td>
</tr>
<tr>
<td>Our contacts in the local business community will be invaluable to your business</td>
<td>We have relationships with leading attorneys, venture capitalists, bankers, and civic leaders. Our partners and staff are active in local not-for-profit organizations and business groups</td>
</tr>
</tbody>
</table>

Remember that the tone of your communication must reinforce your explicit message. If you are positioning yourself as the experts in providing a broad range of services to entrepreneurs, your communication pieces must sound like they were written by someone who has a deep understanding of the issues faced by these businesses and who has a long list of experiences to draw from.

- **Delivery mechanism.** You have to decide how your message will be delivered. Will it be delivered via an email blast or via personal phone calls from your firm’s partners? Again, the delivery vehicle must reinforce your overall brand and messaging. If you
have positioned your firm as being more personal and service oriented than other firms, you reinforce the brand by having your partners make a personal phone call rather than sending out a firm-wide email blast.

- **Logistics.** You need to establish a schedule of what will take place when, and who will be responsible for getting it done. Establishing this level of discipline will help ensure that the plan becomes implemented.

**Tactical Details—The Marketing Campaign**

A marketing campaign is a highly structured form of communication that involves three direct and sequential steps:

- **Awareness.** Clients have to know what you’re selling, and they need to be able to connect your service offering with their business needs. The awareness piece of your marketing campaign must successfully address both of these elements. For example:
  - Congress recently passed tax legislation that will have a significant impact on you and your family-owned business.
  - We provide tax planning services that can help you minimize your liability.

Both elements must be addressed; telling your clients that you offer tax planning without telling them...
about the recent congressional action won’t get you very far.

- **Opinion.** Once you have successfully made your target audience aware of your service offering, and they find it is relevant to their lives, your next move is to shape their opinion by responding to their natural objections, such as:
  - Why are your firm’s tax planning services better than the other firms’?
  - Why should I do something now? Can’t I just hold off for a few months?
  - Do I really need tax planning? I’ve never done any tax planning before; and I’ve turned out just fine. What’s different?

By successfully addressing these types of concerns you put the client in a position to take action.

- **Call to action.** The final step in the marketing campaign is the call to action. You need to get the client or prospective client to do something. It might be to have them sign an engagement letter. Or, it could be an intermediate step on the road to having them sign an engagement letter. For example, “Sign up for our free seminar on the tax law changes in the ARRA.”

These three steps are sequential and you can’t move to a new phase of the process until you are sure that your target has completed the current phase. For example,
you can’t put the hard sell to someone if they have only a vague awareness of what you’re selling and why it is relevant to them.

To gauge your target’s readiness to move on, you will need to continuously follow up with them and understand what they are thinking. Do they understand why tax planning is important? Do they know that proper tax planning could save their business tens of thousands of dollars? Do they understand that choices need to be made right now in order to realize those tax savings?

Only by answering these types of questions can you continue to move your clients and prospective clients closer to the goal of having them sign an engagement letter.

**Tactical Details—The Client Database**

One of the most vital and probably the most overlooked element of a CPA firm’s communication and marketing plan is its database of client contacts. You will never be able to get your message out to people if you don’t have current contact information for them.

At a minimum, such a database should

- contain a complete list of all individuals you will target in your communication and marketing efforts. This list should include current clients and prospects, ex-clients, firm alumni, and other business leaders and contacts in the community.
- contain current contact information for each person. The most valuable piece of contact information will be the email address.
identify other attributes about the contact that will allow you to segment your population and direct targeted messages to individual segments. For example, the information you send to individual tax clients may be different from what you provide the controllers at publicly held companies.

Some firms have been able to successfully manage their client list using a simple spreadsheet or collection of spreadsheets. However, it does not take many records for a spreadsheet application to become too cumbersome to maintain. More sophisticated customer relationship management systems offer other features that even a modest-sized CPA firm will find valuable and cost effective.

Creating a client contact database is only a first step. Once the list is created, your firm must establish procedures to ensure that the information in the database remains complete and accurate. If the integrity of your database becomes compromised, the effectiveness of your communication and marketing efforts will decline.

**Tactical Details—Communication Vehicles**
Your marketing and communication plan will be constrained by vehicles you have at your disposal to distribute your message. For example:

- *The telephone.* Don’t underestimate the value of a personal phone call from one of your firm’s partners to his or her client. Consider two firms, each of which is trying to establish a presence in the renewable energy industry. One morning, the president of a solar energy company gets a brochure from
CPA firm A touting its services for companies in the renewable energy industry. Later that morning he gets a call from the partner at CPA firm B who asks him about his business and talks about ways the firm might be able to help out. Which firm is likely to make the stronger impression?

- **In-person meetings.** Meetings with individual clients or groups of clients are another form of personal contact that can be extremely effective in getting your message out. Like a phone call, the in-person meeting is two-way communication that provides your firm representative the chance not only to deliver the message but also to listen and obtain feedback. This feedback will be invaluable in your efforts to, among other things
  – refine your messages.
  – clarify a new product offering.
  – understand the value proposition of your services.
  – obtain referrals.

- **Your firm’s Web site.** You should carefully evaluate the capabilities of your firm’s website to determine how effectively it will be able to deliver your message. Factors to consider include
  – the volume of traffic to your site and who is most likely to navigate there;
  – whether the content on your site is relatively static or more dynamic and constantly updated; and
– whether the site is capable of delivering multi-
media messages, for example podcasts or short
videos.

- **Other ways to get the message out.** In today’s busi-
ness world you have many options for reaching out
to clients, including the following:
- Personal letters
- E-mail blasts
- Newsletters
- Brochures
- Webcasts
- Live training sessions
- Online meetings

The good news is that all of these services can now be
outsourced so you don’t have to invest resources to
build these capabilities in-house.

**Winning the New Ballgame**

The current recession—like previous recessions—provides
firms with opportunities to expand or, at a minimum, posi-
tion themselves for future expansion during the subse-
quently recovery. Remember that these opportunities will
be defined by client needs. The recession and govern-
ment action do not create opportunity per se. But rather,
these developments change the economic landscape, which affects your clients’ business, which changes their business needs. Your opportunity is to provide a service to address these changing needs.

Maintain this focus on client needs. Successful business development is never about the firm and the services it provides. It’s about the unmet needs of your clients and how you can address them.

**Tax Planning and Compliance**

**The Nature of the Opportunity**

The ARRA created many significant changes to the tax code, and the budget reconciliation scheduled for later in the year will bring even more tax changes, which will affect both individuals and businesses across a wide range of industries. After many years of relatively stable tax laws, the overhaul of the tax code will provide significant business development opportunities for CPA firms in both the tax planning and tax compliance areas.

Their need for tax planning and compliance is immediate—plan on performing these services for 2009. Ideally, though, the work you perform this year will be more than just a one time opportunity. To use the new tax laws to build your practice for the future, consider the example illustrated in the figure on page 89, where your firm expands horizontally from its base. For example:
If your relationships have been on autopilot for the last few years, now is the time to get closer to your existing clients. Tax law changes will force you to learn new things about your clients and their business. Use this chance to increase your visibility and to demonstrate that you are, indeed, their most trusted business advisor.

Aggressively go after new clients. Use your firm’s tax planning services as a way to get in front of new clients. Expand your client base.

In the near future, once the 2009 tax planning and compliance work is completed, you will have a solid base of client support to build on. You will be closer to your long time clients and you will have a group of new clients and now you can begin to offer them additional services they currently purchase from someone else.

Start by understanding the needs of your existing client base. Segment this base into natural groupings so you can have a more detailed understanding of these needs. For example, your construction contractor clients will have different needs than your manufacturing clients. Individuals making less than $250,000 who are saving for their children’s college expenses will have different needs than high-wealth empty nesters.

You’ll want to start your efforts by reaching out to existing clients. You probably won’t have the resources to create a tailored message and reach out to your entire client database, so start by focusing on those clients or
segments of clients where you are likely to enjoy immediate success. Factors to consider when choosing clients for your initial outreach include

- profitability of the engagement;
- the nature of the client relationship and the strength of the relationship; and
- the client’s effectiveness as a referral source.

Communications and Marketing Considerations

One of the keys to implementing an effective marketing strategy will be to clearly define your target market. Almost all of the CPA and law firms that have started to market services around the new tax laws have taken a “shotgun” approach. That is, they have presented all their clients with the same information about the planned and enacted changes to the tax code. Firms that can develop more specific targets will be able to develop more focused communication messages and marketing efforts. This will help you distinguish your firm from the others.

Maintain a relentless focus on client needs. Your expertise is best demonstrated not by reciting changes to the tax code, but instead by describing to your clients how changes to the tax code are relevant to their lives. A major weakness of much of the messaging of tax professionals is that it is presented from the tax preparer’s point of view, for example, by organizing information by code section. Your firm will stand out if you build your message around how you help your clients fulfill their goals, such as buying a home or expanding a business.
It’s tempting to lump tax planning and tax compliance into the same communications bucket because they share the same general base of knowledge, but the perception of these services and the value they provide your clients is quite different, and your communications strategy should reflect those differences.

**Tax Planning**

Tax planning is a consulting service where you provide a unique solution to a complex problem. The client can easily attach a value to the service based on how much you were able to reduce his tax liability. Clients who purchase consulting services of this nature are buying your subject matter expertise and unique problem-solving ability, which means your messaging should emphasize these elements of your brand attributes. You need to position your firm as a thought leader on rapidly emerging changes to the tax code.

As a thought leader your role is to survey the landscape and translate vast amounts of information into knowledge your clients can use to make important decisions. Your value comes from not necessarily knowing all the fine points of the tax code, but rather, in being able to make the broader aspects of the code meaningful to your client’s decision makers. Your primary communications challenge will be to demonstrate to your clients how you have done that in the past and why you will be able to do that again for them now.
One of the keys to establishing yourself as a thought leader is to begin your messaging early. If a dozen other CPA and law firms have already contacted your clients about the tax law changes, you will not be very successful in convincing your clients that you are a leader in this area.

**Tax Compliance Services**

Preparing your client’s tax return is more likely to be perceived by your client as a compliance service. Certainly you have technical expertise, but the angle is not so much that you can use that expertise to solve problems, but that it ensures that you are thorough and comprehensive in your tax preparation. With this angle, you do not need to position your firm as a thought leader, and it’s not necessary for you to offer opinions or projections on what might be included in the legislation. Instead, position the firm as reliable and thoroughly knowledgeable about the laws that already have been passed.

The thought leader isn’t expected to know all the details of the tax code, but if you are providing tax compliance services, you will be expected to have command over all of these details. Clients will engage a thought leader in discussions for which a definitive answer does not exist. Clients are less likely to do that with someone they look to for compliance services. If you are providing tax compliance services your clients will expect you to have the answer.
Unlike tax planning, there is no real advantage in tax compliance services to spending the resources to be on the “bleeding edge” of providing early, real time coverage of the tax laws as they wind their way through the legislative process. Your firm may wish to take the position of simply saying “no one knows for sure how the legislative process will play out. After the law becomes final we will study it closely. Only after we thoroughly understand all the details of the law and their implications will we begin consulting with our clients.” That kind of message will help position your firm as the reliable, thorough professional they want in a tax compliance provider.

**Services for State and Local Government**

**The Nature of the Opportunity**

Firms with expertise in audits of state and local governments and the requirements of Office of Management and Budget (OMB) Circular A-133 are in an excellent position to expand their practice. Two primary drivers of this opportunity exist.

**ARRA Reporting Requirements**

As discussed in the previous section, the reporting requirements of ARRA go far beyond what currently is required of recipients of federal funds. These new requirements include
more frequent reporting.
- the reporting of both financial and nonfinancial information that previously may not have been tracked by the recipient.

At the time this book was written, accounting and reporting guidance was still being finalized, and a great deal of uncertainty remains over many issues, the resolution of which may have a significant impact on recipients.

**A Shortage of Qualified Experts**

Many CPA firms of all sizes perform services for state and local governments. However, a recent study indicates that not all CPA firms who provide services to governmental agencies have the necessary expertise. In 2007, the OMB sponsored a study of the quality of audits performed under A-133. In a sample of 208 audits, only 49 percent of them were found to be acceptable. The rest of the audits were either completely unreliable or of limited reliability.

The President’s Council on Integrity and Efficiency (PCIE) report puts federal fund recipients on notice that expertise in government accounting and auditing standards is vital, and the new complexities brought on by the ARRA will place an even greater premium on expert advice.

**Providing Guidance on the Administration of ARRA Funds**

Since the passage of the ARRA, the OMB has been issuing a steady stream of guidance on how the funds
should be administered. However, this guidance lacks specificity in many areas and the recipients of ARRA funds have many questions.

For example, recipients are required to report the number of jobs created or saved as a result of receiving stimulus funds. Suppose that school district A is considering laying off 30 foreign language teachers as a result of budget shortfalls, but with the receipt of ARRA funds these teachers are not laid off. Jobs saved = 30.

School district B is considering shortening the school year by one week to meet its budget. With the receipt of ARRA funds they do not have to close early and are able to keep their schools open the entire year. Jobs saved = ???

Many ARRA fund recipients will not be up-to-speed on the latest OMB guidance or on best practices for applying that guidance. Help will be needed for these entities to properly administer and report on their ARRA funds. Recipients will want to know whether the procedures they perform to disburse and report on ARRA funds will be considered acceptable by their auditors. They may not have the experience to make judgments about these matters and will be looking for advice from someone who does have that experience. Firms that have that knowledge and the ability to find answers will be in an excellent position to meet the needs of these entities.

**The Need to Clearly Define the Service**

At the present time, a clearly defined market for a specific service has yet to emerge—too many uncertainties
still exist. The most logical service offering would be for you to provide an outsource solution for the administration and reporting of ARRA funds.

An outsourced solution makes sense for many ARRA recipients because the ARRA funding generally is for only two years, and it may not be cost-beneficial for agencies and grant recipients to staff up for a program that will disappear in a short period of time.

The biggest barrier to recipients seeking outsourced solutions is the lack of funding. As this book was being finalized, the House and Senate were considering legislation that would allow 0.5 percent of stimulus funds to be used for administrative costs. If this legislation passes or some other form of funding emerges, then you should see the demand for third party administration and reporting of ARRA funds begin to emerge.

Take Advantage of a Level Playing Field
Pursuing work related to the ARRA is a perfect opportunity for smaller firms to compete against larger ones. The ARRA is new for everyone, which significantly levels the playing field. A CPA firm or even a sole practitioner who gets out there quickly, can establish his or her bona fides in the community before the larger firms can mobilize.

The key for the smaller player is to move quickly. Once the larger firm trains its resources on this practice development opportunity, it will be very difficult to compete.
Communications and Marketing Considerations

If you pursue work related to the ARRA, you will want to highlight your firm’s subject matter expertise. You also should find ways to demonstrate how you are a thought leader who is constantly monitoring the developments in this rapidly evolving area. The key is to demonstrate your thought leadership, not merely talk about it.

Constantly keeping your clients informed of new developments is one way to demonstrate thought leadership. Even if you just pass along content that was created outside your firm, you are providing value. For example, you may provide a link on your Web site to a recent OMB memorandum or you might e-mail that memorandum to a targeted list. Of course, if you can include some of your own insights about the article in your communication, you will provide even more value to your clients and further enhance your position as a thought leader.

Constant communication requires a great deal of time and effort. The good news is that your firm’s partners and other subject matter experts need not be directly involved. With clearly defined goals and parameters and a moderate amount of supervision, your firm’s marketing staff should be up to the task. If you lack this resource, you should be able to delegate the task to an outside communications consultant.

Another way to demonstrate thought leadership is to increase the visibility of your firm’s subject matter experts,
for example, through speaking engagements or participation at industry sponsored conferences or events. Articles written for trade publications can be another good source of visibility, and it is always easy to find a writer to help your subject matter experts create these pieces.

You will want to craft your messages in a way that demonstrates you understand your audience and share their values. Consider the following from an opening paragraph of a firm’s marketing brochure about its government practice: “Our professionals believe in government and are focused on making it more efficient, transparent and effective. In short, we strive to support our clients in their pursuit to make government better.”

This firm holds itself out as having unparalleled “knowledge, expertise and experience” in the public sector. Their emphasis on the public service aspect of the governmental entities will resonate with their audience because it shows that it knows more than just the technical audit and accounting aspects of the Governmental Accounting Standards Board and Circular A-133. Technical mastery is a given. What this firm has communicated is that its professionals understand how those technical requirements are relevant to the entity.

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21 This was taken from a Grant Thornton brochure, “Global Public Sector: Supporting effective government through knowledge, expertise and experience.”
Services for Not-for-Profit Organizations

First Time Single Audits

Many not-for-profit organizations will receive ARRA funding, and they will face the same administration and reporting issues faced by state and local government ARRA fund recipients. But many not-for-profit organizations will face another set of issues that government agencies probably won’t face: preparing for their first A-133 audit.

Organizations that receive more than $500,000 in federal grant money are subject to the audit requirements of A-133. As a result of the vast sums of money being disbursed under ARRA, many not-for-profit organizations will receive significantly increased levels of federal funding, and organizations that previously did not receive $500,000 will meet that threshold and thus be subject to A-133 audit requirements for the first time.

These requirements are complex and place significant demands on both the auditor and the audited organization. Organizations undergoing a Single Audit for the first time probably will not have the in-house expertise necessary to comply, and they will need help. A firm with A-133 expertise may be able to leverage this expertise in two ways.

Financial Statement Preparation and Audit Prep Services

Your firm can provide substantial value by preparing these organizations for their first A-133 audit, for example by
cleaning up their books and records, preparing supporting schedules, gathering documents, and responding to the provided by client (PBC) requests made by the auditors. In this role, you would be acting in the capacity of management, helping the organization prepare for the audit. As a result of your work, the cost of the audit should be much less than it otherwise would have been.

**Perform the Independent Single Audit**

The other alternative for your firm would be to serve as the organization’s independent auditor. Be cautious when performing an audit for an organization that is new to the A-133 reporting world. It is much easier to work with this kind of organization as an advocate than it is to work with them as an independent auditor. In all likelihood, an organization being audited under the A-133 standards for the first time will need a great deal of assistance. Independence rules restrict the types of assistance an independent auditor may provide his or her clients. No such restrictions exist for a third-party advisor who is not the auditor.

**A Difficult Choice**

A firm can not act in the capacity of management and still perform the independent audit. Neither can the firm be in the position of auditing its own work. Consequently, you may have to choose which role to play for your clients. Firms that already have a relationship with a not-for-profit organization may have to make a difficult choice:

- retain the audit and advise the client to engage another third-party to provide financial statement preparation and audit support services, or
become an advisor to the organization and instruct the client to retain the services of another audit firm. It may be possible to be the independent auditor of the organization and still provide management with some form of advisory support. However, you should be very cautious when trying to wear both hats. If you perform an independent audit and it is later determined that your firm was not independent because of the nature of the advisory services it provided, the consequences could be severe, including the need for your client to have its financial statements reaudited by another firm.22

Communications and Marketing Considerations

A-133 audits require a great deal more work and a much higher level of expertise than audits of not-for-profit organizations not subject to A-133 audit requirements. A-133 audits cost more, and your firm can not absorb those costs. The client must be prepared to pay higher fees, and your communication effort must address this issue. To do so, you will need to carefully walk your client through a structured and sequential education process to put them in a position to value the knowledge and experience you will bring to the table.

In order for the client to make such an informed decision about your services and fee structure, you must help

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22 Ethics Interpretation 101-3, “Performance of nonattest services,” under rule 101, Independence (AICPA, Professional Standards, vol. 2, ET sec. 101 par. .05), provides the definitive guidance on nonattest services that a firm may provide for its audit clients.
them understand important qualities of an A-133 audit, including the following:

- Why A-133 now applies to them and why it didn’t in the past
- The requirements of A-133 and how they differ from the requirements of a regular GAAS audit
- The additional procedures required by A-133 and the level of expertise required to perform those procedures properly

Ultimately, you will want your client to engage your firm on the basis of your expertise, so your communication and education processes should be geared toward having the client understand, value, and be willing to pay for A-133 expertise. Until they develop that understanding you will not be able to sell them, so be prepared to make a significant commitment to lay the necessary groundwork.

Begin your communication process as soon as possible. If your clients are even contemplating applying for ARRA funds, you should begin to let them know about ARRA reporting requirements and A-133 audits. Don’t wait for your client to tell you they received a grant that put them over the $500,000 threshold. This is a great chance for you to take the initiative and contact them first to let them know they may be subject to new, more onerous auditing and reporting requirements.
Growth From Emerging Industries: Renewable Energy

For many firms the ideal growth scenario would be to develop a close relationship with a small company that grew into a large company. Better yet, would be to provide services and become known for your expertise in a small industry that grows into a big industry.

Consider the accounting firm located in Silicon Valley circa 1994. Into the firm walks the business owner of a small company looking for a CPA to help him with his business that is built around something called the World Wide Web. And he’s part of an industry group made up of other business owners in Silicon Valley who have similar business based on this “Internet.” Wouldn’t we all love to have been in that position?

Is there another industry today that is comparable to the high-tech and Internet-based business 15 years ago?

Keep your eye on wind and solar and other sources of renewable energy. The following are some things to consider:

- Public Policy. With the passage of the ARRA and the economic blueprint described in its budget proposal, the Obama administration has indicated it will be making significant investments in the renewable
energy sector. Congress is considering legislation that will require utilities to generate at least 15 percent of their electricity from renewable energy sources by the end of the next decade. Currently, about 2 percent of the nation’s energy comes from renewable sources. The amount of the U.S. electricity supply coming from renewable energy sources would gradually increase to 4 percent in 2011–2012, 8 percent in 2013–2015, 12 percent in 2016–2018, 16 percent in 2019–2020 and 20 percent in 2021–2039.

- **Recent Growth Trends.** The renewable energy industry is one of the fastest growing sectors of the economy. According to the American Solar Energy Society, in 2007, the solar energy industry grew at 3 times the rate of the U.S. economy, with some segments of the industry experiencing growth rates of 25 percent or more. The Energy Information Association reports that renewable energy production in the first quarter of 2009 was up 12 percent from the first quarter of 2008.

- **Opportunities for All CPA Firms.** Not all regions of the country benefitted from the expansion of the high-tech and Internet-based industries, which was concentrated in Silicon Valley and other major

23 It’s worth noting that the federal government’s strategy is designed to provide a significant boost to the growth that already is occurring within the industry. The aim is to generate critical mass and momentum that will attract private capital and create a self-sustaining industry. That is, if things work out as planned, future growth of the industry will not depend on increased funding from the federal government.


Investing for the Long-Term

Cities such as Boston and Washington D.C. By contrast, the renewable energy industry is nationwide. For example, the American Wind Energy Association (wind energy is the fastest growing segment of the renewable energy industry) reports that as of the end of the first quarter of 2009, wind power projects had been completed or underway in 25 different states.26 The chart on the following page shows the growth of wind power in all 50 states.27

Building a Renewable Energy Practice

Firms with experience in helping entrepreneurial businesses grow may find significant opportunities to build a renewable energy practice. Some firms already have begun to develop such a practice.28 In addition to traditional financial reporting and tax compliance services, these firms offer other services such as the following:

- Consulting on a variety of issues relating to the Renewable Energy Tax Credit and other provisions of the tax code
- Structuring renewable energy transactions
- Initial project feasibility studies and financial projections
- Assistance in securing debt and equity financing
- Outsourced financial management

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### Added Most Capacity in 2008

<table>
<thead>
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<th>State</th>
<th>Capacity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Texas</td>
<td>2671.3 MW</td>
</tr>
<tr>
<td>Iowa</td>
<td>1599.8 MW</td>
</tr>
<tr>
<td>Minnesota</td>
<td>455.85 MW</td>
</tr>
<tr>
<td>Kansas</td>
<td>450.3 MW</td>
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<tr>
<td>New York</td>
<td>407 MW</td>
</tr>
</tbody>
</table>

### Fastest Growth in 2008

<table>
<thead>
<tr>
<th>State</th>
<th>Capacity</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indiana</td>
<td>first utility-scale project</td>
<td></td>
</tr>
<tr>
<td>Michigan</td>
<td>48x</td>
<td></td>
</tr>
<tr>
<td>Utah</td>
<td>21x</td>
<td></td>
</tr>
<tr>
<td>New Hampshire</td>
<td>17x</td>
<td></td>
</tr>
<tr>
<td>Wisconsin</td>
<td>6x</td>
<td></td>
</tr>
</tbody>
</table>

### Highest share of electricity from wind in 2008

<table>
<thead>
<tr>
<th>State</th>
<th>Capacity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minnesota</td>
<td>7.48%</td>
</tr>
<tr>
<td>Iowa</td>
<td>7.10%</td>
</tr>
<tr>
<td>Colorado</td>
<td>5.91%</td>
</tr>
<tr>
<td>North Dakota</td>
<td>4.86%</td>
</tr>
<tr>
<td>New Mexico</td>
<td>4.41%</td>
</tr>
</tbody>
</table>

*Source: AWEA*
Firms will need to decide for themselves how much effort they should invest in building a renewable energy practice. Firms with limited resources may not be able to formally plan and launch such a practice. Nevertheless, it would be wise to be on the alert for local companies involved in wind, solar, and other renewable energy businesses.

Conclusion: What It All Means for CPAs

Follow the Money

In response to a once-in-a generation recession, the federal government is taking bold, once-in-a-generation action, and they are redirecting huge sums of money to middle class tax relief, education, energy, and health-care. Follow the money, for it leads to new business.

Public policy changes can create business development opportunities for CPA firms. Consider the last big public policy change affecting the business community, the Sarbanes-Oxley Act of 2002. Among other things, that new law required publicly traded companies to test and report on their company’s internal control. It also required independent auditors to audit the company’s internal controls. Consulting services to help companies comply with the Sarbanes-Oxley Act internal control requirements together with the increased audit requirements created significant amounts of new business for the profession.
This new business was not confined to the large national firms. Smaller firms that were forward thinking, nimble, and aggressive were able to take advantage of these opportunities too, either through their own business development efforts or by establishing referral relationships with larger firms.

**It’s All How You Look at It**

The current recession is deep, and the changes coming from Washington are staggering in their scope. The stimulus bill, the budget, and other changes that may soon be coming will fundamentally restructure the U.S. economy. And while all of that is going on, the playing field (and the rules of the game) will become increasingly global and technology will completely transform the way we do things, possibly several times over.

Interesting times? Indeed. But it’s all how you look at it. Viewed from the right frame of mind, this “curse” is actually a blessing for firms willing to accept the inevitable risks, embrace change, and forge ahead with an intent and well reasoned plan to present clients with the services they need now rather than lamenting the decrease in demand for the services clients needed yesterday, when the market was more bullish and their balance sheets more robust.

The current economic climate is difficult, and CPAs are faced with issues they may not have seen in their professional careers and may not see again. But change brings
opportunity. Do not let the headlines fool you; it is possible to succeed, and to grow, in this climate. Initiatives to drive down costs are at the forefront of most firms’ strategic planning right now, in part, because risk-level appropriate cost containment is always smart practice and because this is familiar territory that we understand and feel comfortable implementing. But the firms that will grow in this new environment are the ones that take the calculated risk of getting out of their comfort zone and—in the cases where it makes sense—putting their resources in play to grow new lines of business.

These are historic times as our economy is poised to move in an entirely new direction. CPA firms should position themselves to move in that same direction.
Additional Resources

www.pcps.aicpa.org
The PCPS Firm Practice Center contains a wealth of resources for all firms affiliated with the AICPA to harness business opportunities and overcome challenges in their firms. PCPS – the AICPA Private Companies Practice Section – provides a rich array of valuable information and resources for firms of all sizes in the area of practice management.

www.recovery.gov
This officially sponsored federal government site contains a wealth of information and resources on issues related to economic conditions and specifically to the American Recovery and Reinvestment Act (ARRA).

www.economy.aicpa.org
AICPA’s Economic Crisis Resource Center is continually updated and contains information and resources, lists of products and tools available from AICPA, podcasts, videos and other information to help you and your clients during these turbulent times.

www.whitehouse.gov/OMB
The Office of Management and Budget makes a variety of materials on the Federal Budget and ARRA available to the public on their Web site.
**www.stat-USA.gov**

STAT-USA/Internet, a service of the U.S. Department of Commerce, is a single point of access to authoritative business, trade, and economic information from across the Federal Government.

**www.businessofgovernment.org**

The IBM Center for the Business of Government provides resources addressing the major management issues facing the government and not-for-profit sectors, including those related to the federal government’s response to the current recession.

**www.gaqc.aicpa.org**

The Government Audit Quality Center is a membership based center that offers tools and resources to assist members with performing high quality government audits. Information on breaking issues regarding ARRA in the government audit context is available.

**www.theeyeshade.com**

The author’s blog, addressing contemporary auditing issues, business development, and communications and marketing.
Step up to the plate! This pocket-size guide coaches CPA firms on how to capture the opportunities of a post-recession economy. In his second book in the Practice Forward series, author Michael Ramos leads you through new service offerings, leveraging client relationships and revising communication and marketing strategies to respond to the new economic climate.

Learn how to take improving economic conditions into account as you
• assess your firm’s business strategy,
• analyze new sources of revenue growth,
• refine your communication and marketing strategy in a reviving economy and
• leverage your expertise and client relationships to capture emerging service offerings.

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