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An AICPA publication for the local firm

FINANCING FIRM GROWTH IN THE 1980s

Various state societies, MAP conferences and associations conduct surveys to give practitioners an opportunity to compare their financial results with others. I have reviewed a number of these surveys and have been amazed at the wide variance in earnings between practices. Some do extremely well, many do not.

Those who are not doing well now are going to have increased difficulty in the future unless they become better business people. Continued inflation and a more competitive environment will only accelerate the problem. Inflation affects all firms—it has a direct impact on accounts receivable, work in process and personnel. Partnership and staff needs increase, and continued changes in office technology require larger investments. These conditions put added pressure on profit margins, necessitate better planning and budgeting and create a need in CPA firms for short- and long-term financing.

Our experience has been that change takes time—as much as three to five years. The reason for this is that improved performance is a gradual process. For example, asking partners to improve accounts receivable and work in process from 115 days to 75 days would be viewed by most as impossible and they would not even try. On the other hand, a goal to go from 115 days to 105 days is realistic and can be achieved. Once you are at 105 days, it is time for a new goal—90 days and so on. It has taken our firm two to three years to go from 115 days to 75 days. Some offices still have not made it while others consistently run 60 days. To achieve this type of goal you will need to modify engagement letters, assess clients' financial strength, require advance deposits, shorten progress terms, charge interest, etc. You will also have to monitor billings and collections carefully and require that work in process is billed currently.

The following comments concern some other areas of practice management where serious problems could surface and offer some suggestions for dealing with them.

Salary requirements have been rising rapidly but it is not the supply of or demand for accountants that is the main reason for this. Inflation and soaring housing prices are a major factor because they have made the cost of moving people from one area to another prohibitively expensive for larger firms. This has increased the competition for outstanding people in the local market.

Your competition knows who these talented people are, so it is to your benefit to be aware of the going rates and pay competitive salaries. If your salaries aren't competitive, you risk losing your best people. And you can only pay competitive salaries if you are as profitable as other firms in your area.

Small firms have a real advantage when it comes to people relationships. Being small makes it easier to train, develop and motivate personnel. Unfortunately smallness also breeds informality which can lead to personnel problems. There is a

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What's Inside . . .

AICPA MAP Committee Urges Comment On Financial Reporting Documents

The AICPA's management of an accounting practice committee has asked state society MAP committees to urge practitioners to comment on two documents that are of special interest to practitioners.

- ☐ An FASB Invitation to Comment on Financial Reporting By Private and Small Companies. The purpose of the document is to gather information to help the FASB clarify how financial reporting needs of private and small companies differ from those of other companies.
- ☐ A discussion paper issued by the AICPA's special committee on accounting standards overload, which was formed to consider alternative means of providing relief from accounting standards whose cost of application and use are deemed to exceed their benefits, particularly for small or closely held companies.

Comments on both documents are due by May 31, 1982.

The Institute's MAP committee strongly urges AICPA and state society members to respond because their comments on these documents will help determine future standards that will affect almost all practice units.

Copies of the FASB document can be obtained from FASB order department (203) 356-1990.

Copies of the AICPA document can be obtained from AICPA order department (212) 575-6426.

The AICPA Computer Conference

The Institute's annual computer conference will be held this year on May 24-26 at the Hyatt Regency Hotel in Kansas City, Missouri. The theme of the conference is "The Impact of Minicomputers and Microcomputers on the Accounting Profession." Subjects discussed will include basic minicomputer concepts, distributed processing, word processing, use of minis and micros in a tax practice and examples of software and data-management packages. In addition, participants will be able to obtain hands-on experience in the use of microcomputers from four major manufacturers.

Recommended CPE credit is 21 hours. Registration fee is $325. For further information, contact the AICPA meetings department.

Improving IRS Forms

The AICPA tax division would like your help in formulating recommendations for improvements in IRS forms and instructions. To make this easy and to simplify compilations and comparisons, it has devised its own form. So if you think you may have any suggestions while you are working on tax returns, please write to the AICPA's Washington office for a copy of the tax division's form or submit your comments in the format shown below. Send all the details before April 15 to Rob Clayton, AICPA, 1620 Eye Street, N.W., Washington, D.C. 20006.

FORM OR INSTRUCTION	PAGE OR SCHEDULE	PROBLEM	SUGGESTED SOLUTIONS

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Highlights of Recent Pronouncements

FASB Statements of Financial Accounting Standards (SFASs)

No. 53 (December 1981), *Financial Reporting by Producers and Distributors of Motion Picture Films*

- ☐ Extracts the specialized accounting principles and practices from the AICPA Industry Accounting Guide, *Accounting for Motion Picture Films*, and SOP 79-4, *Accounting for Motion Picture Films.*
- ☐ Establishes standards of financial accounting and reporting for producers and distributors of motion picture films.
- ☐ Exhibition rights transferred under license agreements for television program material shall be accounted for like sales by the licensor. The sale shall be recognized by the licensor when the license period begins and certain specified conditions have been met.
- ☐ Producers and distributors that license film exhibition rights to movie theaters generally shall recognize revenue when the films are shown. Describes how producers and distributors shall account for film costs and participation agreements.
- ☐ Effective for financial statements for fiscal years beginning after December 15, 1981.

No. 52 (December 1981), *Foreign Currency Translation*

- ☐ Replaces FASB Statement no. 8 and revises the existing accounting and reporting requirements for translation of foreign currency transactions and foreign currency financial statements.
- ☐ Presents standards for foreign currency translation that are designed to (1) provide information that is generally compatible with the expected economic effects of a rate change on an enterprise's cash flows and equity and (2) reflect in consolidated statements the financial results and relationships as measured in the primary currency in which each entity conducts its business.
- ☐ Effective for fiscal years beginning on or after December 15, 1982.

No. 51 (November 1981), *Financial Reporting by Cable Television Companies*

- ☐ Extracts the specialized accounting principles and practices from SOP 79-2, *Accounting by Cable Television Companies.*
- ☐ Establishes standards of financial accounting and reporting for costs, expenses and revenues applicable to the construction and operation of a cable television system.
- ☐ During the prematurity period, costs incurred that relate to both current and future operations shall be partially capitalized and partially expensed.
- ☐ Effective for fiscal years beginning after December 15, 1981.

No. 50 (November 1981), *Financial Reporting in the Record and Music Industry*

- ☐ Extracts the specialized principles and practices from SOP 76-1, *Accounting Practices in the Record and Music Industry.*
- ☐ Establishes standards of financial accounting and reporting for licensors and licensees in the record and music industry; also establishes standards for artist compensation cost and cost of record masters.
- ☐ Requires the licensor to recognize the licensing fee as revenue, if a license agreement is, in substance, an outright sale and collectibility of the licensing fee is reasonably assured. Requires a licensee to record minimum guarantees as assets and charge them to expense in accordance with the terms of the license agreement.
- ☐ Effective for fiscal years beginning after December 15, 1981. The provisions of this statement shall be applied retroactively and any accompanying financial statements presented for prior periods shall be restated.

No. 49 (June 1981), *Accounting for Product Financing Arrangements*

- ☐ Extracts the specialized principles and practices from SOP 78-8, *Accounting for Product Financing Arrangements.*
- ☐ Specifies criteria for determining when an arrangement involving the sale of inventory is in substance a financing arrangement.
- ☐ Requires product financing arrangements to be accounted for as borrowings rather than as sales.
- ☐ Applies to arrangements entered into after June 15, 1981.

No. 48 (June 1981), *Revenue Recognition When Right of Return Exists*

- ☐ Extracts the specialized principles and practices from SOP 75-1, *Revenue Recognition When Right of Return Exists.*
- ☐ Specifies how an enterprise should account for sales of its product when the buyer has a right to return it; revenue shall be recognized at time of sale only if all the conditions specified by the statement are met.
- ☐ Effective for fiscal years beginning after June 15, 1981. Accounting changes to con-

form to the statement are to be applied retroactively.

FASB Interpretations

No. 36 (October 1981), *Accounting for Exploratory Wells in Progress at the End of a Period* (interprets SFAS no. 19)

No. 35 (May 1981), *Criteria for Applying the Equity Method of Accounting for Investments in Common Stock* (interprets APB Opinion no. 18)

Statements on Auditing Standards

No. 39 (June 1981), *Auditing Sampling*

- ☐ Supersedes SAS no. 1, sections 320A and 320B.
- ☐ Provides guidance on nonstatistical and statistical sampling; sampling for substantive tests of details and sampling for compliance tests of internal accounting controls.
- ☐ Effective for examinations of financial statements for periods ended on or after June 25, 1982.

No. 38 (April 1981), *Letters for Underwriters*

- ☐ Supersedes SAS no. 1, section 630.
- ☐ Changes are in response to SEC revisions of reporting requirements and changes in professional standards relating primarily to reviews of interim financial information.

No. 37 (April 1981), *Filings Under Federal Securities Statutes*

- ☐ Supersedes SAS no. 1, section 710.
- ☐ Provides guidance for the accountant when his report based on a review of interim financial information is presented or incorporated by reference in a filing under the Securities Act of 1933.

No. 36 (April 1981), *Review of Interim Financial Information*

- ☐ Supersedes SAS no. 24.
- ☐ Changes are in response to the SEC's revisions to Regulation S-K and deal with the effects on the auditor's report when interim financial information accompanies audited financial statements.
- ☐ Guidance in SAS no. 24 on the accountant's procedures for a review of interim financial information and the form of the accountant's review report are unchanged.

No. 35 (April 1981), *Special Reports — Applying Agreed-Upon Procedures to Specified Elements, Accounts, or Items of a Financial Statement*

- ☐ Amends SAS no. 14 to permit an accountant's report to be accompanied by an entity's financial statements.

No. 34 (March 1981), *The Auditor's Considerations When a Question Arises About an Entity's Continued Existence*

- ☐ Provides guidance on the auditor's considerations when information comes to his attention that raises a question about an entity's ability to continue to exist.
- ☐ Discusses the effects on the auditor's report and presents illustrative reporting language.

Statements on Standards for Accounting and Review Services

No. 4 (December 1981), *Communications Between Predecessor and Successor Accountants*

- ☐ Provides guidance to a successor accountant who decides to communicate with a predecessor accountant regarding acceptance of an engagement to compile or review the financial statements of a nonpublic entity.
- ☐ Requires the predecessor to respond promptly and fully in the event of such communications in ordinary circumstances.
- ☐ Provides guidance on additional inquiries a successor accountant may wish to make of a predecessor, and the predecessor's responses, to facilitate the conduct of the successor's compilation or review engagement.

No. 3 (December 1981), *Compilation Reports on Financial Statements Included in Certain Prescribed Forms*

- ☐ Amends SSARS 1 and SSARS 2 to provide for an alternative form of standard compilation report when the prescribed form or related instructions call for departure from generally accepted accounting principles by specifying a measurement principle not in conformity with generally accepted accounting principles or by failing to request the disclosures required by generally accepted accounting principles.
- ☐ Provides additional guidance applicable to reports on financial statements included in a prescribed form.

Statement on Standards for Management Advisory Services

No. 1 (December 1981), *Definitions and Standards for MAS Practice*

- ☐ Provides guidance to members regarding rule 201 of the AICPA Rules of Conduct within the context of management advisory services and establishes, under rule 204, other standards deemed appropriate for such services.
- ☐ Defines management advisory services, engagements and consultations.
- ☐ Effective for MAS rendered after May 1, 1982.

Financing Firm Growth
(continued from page 1)

need to formalize personnel policies in a way that requires us to provide timely and effective performance and career counseling to staff. Perhaps you should think about giving earlier recognition to outstanding people—even to shortening the time to partnership. You might also consider offering financial assistance if yours is an area with exceptionally high housing costs.

Facility costs continue to skyrocket and may force a decision as to whether you can continue to stay in your present location. Some of the alternatives to paying exorbitant rents are buying your own building or forming a joint venture with other professionals to do the same. Such an investment can not only be an inflation hedge but can also provide for retirement. If, however, you decide to continue renting, you should consider renegotiating your lease three to five years before it expires.

Now what about replacing office equipment? Having a computer or terminals is becoming almost mandatory for CPA firms. The use of word processing equipment is growing too. These machines can pay dividends in terms of increased productivity, but do not expect them to result in any reduction in the number of staff. In reality, the key to making the equipment pay for itself is to make sure that it is utilized by all staff and for as many activities as possible (see "Making Use of Word Processors" in the October *Practicing CPA* and Mr. Deforgee's letter to the editor in the December issue).

Telephone systems can now be purchased or leased. In the four or five situations where we have made the buy/lease comparison we have always chosen to buy—even in these times of high interest costs. Give a lot of weight to the vendor's ability to service the equipment when making this decision.

Partner retirement provisions can seem onerous to younger partners and some revisions may be in order. To begin with, the retirement process should be an orderly one resulting from a carefully designed plan that is fully integrated with the firm's long-range operating forecast. The retiring partner should obviously receive everything rightfully due him but the method and amount of payment should not place an undue burden on the firm. To protect the firm, the partnership agreement should provide for limitations in cost of living adjustments and on the percentage of income to be paid for retirement. Our agreement provides for an 8 percent cost of living limit and 17 percent of partnership income. The agreement should also spell out what happens if the limits are exceeded. The survival of the partnership must always be the foremost consideration.

Formal quality control is undoubtedly here to stay. Undoubtedly, too, it costs quite a lot of money. Peer reviews can involve considerable amounts of time on the part of high-level personnel and the initial investment in quality control can be high. However, there is also no doubt that quality control results in a higher standard of services to clients to the betterment of firm and profession. We believe that we are doing a better job in our firm because of quality control and that there are benefits accruing to the firm. We also think that the costs will diminish in time as procedures become streamlined and accepted. Personnel also benefit since more formal written policies have forced us to give more than lip service to performance evaluations and counseling. It is just good business.

The direct costs of continuing education have increased as a percentage of net fees in the last few years—ours are now about 2 percent. It has become increasingly expensive to send staff to distant training seminars. Expenses can be reduced through use of local programs where possible or by having the instructor go to the people, not the other way around. Another idea is to get some audiovisual equipment and use the programs produced by the AICPA CPE division and others. We find that a 19-inch monitor is adequate for most CPE uses and you can always link several together for larger groups. At the present time there are a number of management training programs available. Technical programs have been slow in coming.

Marketing is a new area for most firms but it seems certain to become more important in the years ahead. Each year we budget more and more money to this area. The main idea of marketing is to capitalize on your firm's strengths—its specialties, industry expertise, etc. So plan carefully before you proceed with a marketing program. Decide how much you wish to spend, test the program against appropriate criteria, decide who you should put in charge and whether or not you should hire outside consultants. We hired a marketing professor to assist us in establishing the proper criteria for a marketing program. To date we have not elected to spend much on advertising but I am sure it will be a regular budget item before long.

CPAs are typically conservative when it comes

Becoming Better Business People

An overly large investment in accounts receivable and work in process usually goes hand in hand with poor financial performance. The following case study shows why one of our offices had a 180-day investment when first merged into our firm and describes the procedures used to reduce this over a two-year period to a 50-day investment and significantly improve the office's results.

The causes

- ☐ Low productivity and quality of work.
- ☐ Too many marginal clients.
- ☐ Staff's negative attitude resulted in billing rates being set too low.
- ☐ Lack of both training in and emphasis on billing and collection.

Remedial procedures

- ☐ The importance of billing and collection emphasized.
  - (1) Partner-in-charge holds monthly meetings.
  - (2) All unbilled work in process must be approved by partner-in-charge.
  - (3) All downward fee adjustments must be approved by partner-in-charge.
  - (4) Billings given priority over client services.
- ☐ More selectivity used in obtaining and retaining clients.
- ☐ Compliment people who improve their billing and collection (especially effective at billing meetings).
- ☐ Reward those who perform up to standard and penalize or discharge those who are unwilling to make improvements.

Billing techniques

- ☐ When possible, fees and billing arrangements are discussed with client at first meeting. All new 1040 clients are given a leaflet stating minimum fee and billing process: All other clients receive an engagement letter describing billing arrangement and fees.
- ☐ Except for clients with an established credit rating, obtain 25 percent of the estimated fee at the beginning of the engagement and the balance on completion.
- ☐ The standard billing statement form should indicate that a service charge will be added to billing not collected within 30 days.
- ☐ Use variable billing rates depending on a person's expertise in given areas.

Engagement administration

- ☐ Never sell clients services they don't need.
- ☐ People performing fieldwork on major engagements should develop time budgets to be approved by partner or manager beforehand.
- ☐ Inform clients promptly of any problems that will increase the time on an engagement. Let their staff make corrections if so desired. If not, tell them what the effect will be on fees.
- ☐ Partners, managers and supervisors should be active in engagements because
  - (1) Staff learn more rapidly and morale is improved.
  - (2) The person with billing responsibility is assured of first-hand knowledge of any problems encountered.
  - (3) It makes discussing fees easier.
  - (4) Most jobs get done in less time resulting in lower fees and easier billing and collection.
  - (5) Partners' and managers' chargeable hours are increased and the firm is more profitable.
- ☐ Bill twice a month during tax season.

This office had about eleven thousand chargeable hours, one partner and earned about $20,000 when it merged with our firm. Utilizing the above techniques, the office was earning about $125,000 with roughly the same number of chargeable hours and one partner two years later.

to borrowing money. Some believe in the need to look as solid as the Rock of Gibraltar. Others, usually younger partners, are much more liberal in their attitudes toward borrowing. As inflation continues, capital expenditures requirements increase, partners retire and our need for borrowing increases. We can "find" cash by better managing billing and collections, fee adjustments, etc., but sometimes that is not enough and we need to establish lines of credit and long-term financing. CPAs are good credit risks and should be able to borrow as much money as they need! Believing that statement is the first step in obtaining a working relationship with a financial institution. If that belief does not come easily I would suggest pulling the financials on some of your marginal clients to see how much they have borrowed. That should develop your confidence! Another factor in our favor is that bankers consider us a good referral source, which we are. Projecting future needs (say three years) will then provide a basis for conservative and liberal partners to work out a "comfort zone" for borrowing. You need to balance risk against need, with enough capital to see you through a downturn and to avoid embarrassments. We have a formula for determining required capital for partners and pay interest, at the going rate, for capital in excess of the determined amount. This provides incentives for some to leave funds in the firm. We still borrow all year round from the bank and have current and long-term financing. Our long-term financing is collateralized by our computer, equipment and even leasehold improvements.

It is important to establish an attitude that change is good for the firm. Problems don't go away and inequities that arise from time to time as a firm grows can often only be resolved by making changes in the firm's partnership structure. Partnership flexibility will better enable the firm to respond to a changing environment and take advantage of opportunities. Our agreement has been changed at least 15 times in the last five years. Hopefully our partners realize that nothing is cast in granite and that their suggestions for improvement will be heard.

If you have a strong need to improve your firm's performance but do not know where to start, I strongly recommend the AICPA management review program. For $1,600 you can have a complete diagnosis of your firm's ills as well as suggestions for improvement. That has to be the best deal in town! (Contact Nancy Myers, director, industry and practice management at the AICPA.)

The above are just a few ideas for coping with your firm's growth during the 1980s. Most of us can finance a significant portion of this growth internally by simply practicing what we preach—being good business people. If we are that, the remainder of our needs can easily be met through outside sources.

—by Gerald L. Yonke, CPA
Seattle, Washington

Is Profit Planning Necessary?

When I discuss the various aspects of managing an accounting firm with other CPAs, I am constantly surprised to find that most of them do not use any type of financial planning for the year ahead. We find that there are decided benefits to projecting billings, net fees, expenses and profits, etc., and have been doing this for the past six or seven years. Some of the main reasons for preparing a firm profit plan are that it

- ☐ Aids in determining objectives and in evaluating the practice.
- ☐ Helps in the assignment of partner and staff responsibilities.
- ☐ Obtains a commitment from all personnel.
- ☐ Permits determination of how much time and money should be contributed to professional and community activities and to professional development.
- ☐ Is a means of measuring performance.
- ☐ Allows us to ascertain financial considerations.
- ☐ Reduces the likelihood of crises or unpleasant surprises.
- ☐ Makes us evaluate fees at least annually.

A good productivity and financial plan enables you to run your practice, rather than having it run you. It makes you a manager of your firm's financial capabilities and provides the profit you expect. And by involving staff people in the plan, you not only motivate them into meeting goals but the firm also benefits by the coordination of activities toward a common goal.

There are several points to consider prior to implementing a profit plan. You should make sure that

- ☐ All personnel are aware that they have a commitment to accomplishing the plan which includes client assignments, percentage of chargeable hours, administrative duties, business development, professional organization and community involvement.
- ☐ Financial results, staff productivity and other firm goals will be reviewed monthly.
- ☐ Problems can be caught and dealt with early.
- ☐ Staff members will be notified in writing of their progress on a monthly or quarterly basis.
- ☐ The importance of controlling expenses will not be forgotten.
- ☐ There is a clearly defined policy of what time is chargeable and what time is not.

At the end of the year, you can compare the actual results with what was planned. This can provide important data for use in partner and staff evaluations, in formulating the next year's plan and for making adjustments in the firm's long-range plan.

Profit planning has provided our firm with goals, controls and, most importantly, with the knowledge of what our abilities can provide in the way of overall firm profits. This is a different concept from the old "what are we worth" way of thinking.

– by Jerrell A. Atkinson, CPA
Albuquerque, New Mexico

Think Small Again

According to an article in the *Wall Street Journal* last October, many state courts now require that filings utilize 8½-by-11-inch (letter-size) paper. In fact, it seems that the old legal-size paper (8½-by-14-inch) is becoming nonlegal as far as these courts are concerned. However, we think the lawyers are miles behind accountants when it comes to taking that first big 3-inch step downwards.

Back in November 1977, in the very first issue of the *Practicing CPA* (or the *CPA Practitioner*, as it was then called), Houston Smith, a Decatur, Georgia CPA pointed out some advantages to CPA firms of using the smaller-size paper. For example, 8½-by-11-inch workpapers.

- ☐ Can be conveniently kept in three-ring binders while a job is in process.
- ☐ Are usually filed sideways, making it easier to read, remove and replace them.
- ☐ Require smaller file cabinets and the pads are less expensive.
- ☐ Are the same size as tax returns, attach neatly, and in most instances one sheet is all that is needed.

The legal profession can cite a few brief advantages, too. They say that making legal papers standard at 8½-by-11 will dispense with the need to stock different sizes of copying machine paper, and save microfilm and microfiche space because copying different size documents wastes film space. Still, one lawyer has apparently filed a dissenting opinion. His case is that the required paper size will continue to shrink until everyone is directed to file microdots. The judge then will be able to carry a whole file in his snuffbox.

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