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Practicing CPA, vol. 13 no. 3, March 1989

American Institute of Certified Public Accountants (AICPA)

The Practicing CPA

MARCH 1989

An AICPA publication for the local firm

GROWTH AND PROFIT THROUGH SPECIALIZATION

In 1978, I withdrew from a local firm that had about thirteen people in total. As managing partner, I found I spent most of my time managing the firm and lost much of the opportunity for client contact. For this and other reasons, I decided to start my own firm, and I began as a sole practitioner that year.

By agreement, some clients and two of the support staff came with me. Later, I hired another CPA, so there were four of us in the firm.

My first decision was to drop some clients because they did not suit my practice and to set up a procedure to annually review all clients to make sure they were still what I wanted. Then, I looked at our average chargeable rate per hour and decided that we should start raising our fees regularly and computerize every function possible.

To improve collection, I thought we should spend more time than previously in selling our services to clients, and we should establish our billing and payment schedule with clients prior to beginning any engagement. I drew up our first five-year business plan and developed a firm philosophy, particularly regarding the type of practice I wanted.

Selecting a specialty

Having no audit clients, and desiring none, I decided to specialize in tax and write-up work, and to concentrate on serving the medical and professional fields. We already had a lot of these clients in our practice. We enjoyed working with them, and saw terrific potential for future services as we developed further expertise. Most of these clients were not large enough to have their own bookkeepers, and we could begin by providing computerized bookkeeping services that supplied them with management data.

At the time, many of these clients were considering incorporating, and we were able to help them. Pension and profit-sharing planning naturally followed. Soon, we saw their need for tax and estate planning, and the need for the review of their life insurance programs. Personal financial planning was the next logical step.

We saw that as we gave these clients more attention and personalized service, we could realize higher fees without incurring their resistance.

Remaining a small firm

At about that time in the development of our specialty, we made a critical decision—to remain a small firm. As a first step, everyone attended time management sessions to ensure we got the most out of each day.

We had to be extremely efficient to achieve our goals. Instead of more clients, we wanted to do more work for present clients. While this meant turning down some new clients, we realized that much of our growth had come from client referrals—people who had already been sold on our firm, our type of practice, our fee structure, etc., before we took them on as clients. We knew then, we could have the type of practice we wanted, and began to work in earnest on our specialty.

In the firm today, we have three partners, two associates, and a part-time college student. Our bad debts during this period have been $2,475 on a total of over $3 million in fees. Collectibility has improved as a result of the initial client discussions. Our write-down from standard rates averages three percent.

How to specialize

Start by evaluating the services you now provide. Determine what your staff does best. In other words, what are your existing areas of expertise? Then, review your fees by services. See if your fees are high in some areas and low in others.

The next step is to evaluate your clients. List them by industry and by fees paid over a twelve-month period. See if there are any who are just not developing into the type of client you want. Determine who your most successful clients are and identify services you are not yet providing them. List the clients with the most potential for future growth.

The important factor in deciding on a specialty is to match the expertise in the firm with the needs of key clients. You need input from everyone in order to determine just what your specialty is. The results are better when people like what they are doing and enjoy the clients with whom they work.

How to promote your specialty

We decided to promote our specialty by providing full service to our clients. By that, I mean being available to them. Usually, clients call when they have a problem, so every phone call is returned by someone the same day. The secretary keeps a log of every incoming phone call which partners and associates can review the next day to check that appropriate action has been taken. We concentrate on giving good service and don't let a month go by without making some contact with each client.

Telephone calls are the easiest way to keep in touch. Lunches are good, too. Doctors are sometimes only available at certain times, so we change our schedules to fit theirs. Other ways to keep in touch are through client newsletters and seminars. Over the years, most of our good clients have become good friends.

Clients need to understand your firm, what you can do for them, and what you expect from them. Select new clients carefully. Spend sufficient time with prospects to be sure you have a mutual understanding. They should be aware that you require timely information from them, and understand how you bill and when you expect to be paid. We also ask when the prospect needs the work to be performed, to determine if these time requirements fit into our schedule.

To specialize successfully, you must continually upgrade your practice. This necessitates annual client evaluations in order to weed out those who do not meet your requirements. This process makes room for clients who do. For us, poor client traits include: (1) always being late in sending us information and work, (2) never referring business, (3) being hostile to our associates, (4) complaining about our fees, (5) always paying our bill late, (6) operating a declining business.

One of the reasons we chose our particular specialty was that we believed it had excellent growth potential. We later added the real estate development business as another specialty for the same reason. If you tie your specialty to a vulnerable industry, you could have some serious problems in an economic downturn. Be careful in your choice. Make sure your studies include the specialty's prospects for present and continued economic strength.

When to specialize

When should you specialize? Start today. Think about your areas of expertise and who your best clients are, and see if the two match. Prepare a five-year business plan. If your practice is sixty percent tax and forty percent audit, for example, giving up auditing would be a major change. You would need to look at staffing requirements, and program the changes over a five-year period.

Include everyone when discussing your plans. We try to give people responsibility, and we utilize various arrangements in order to give them part of our profit. Our desire to provide more services to our clients—yet remain a small firm—means the five of us must keep up-to-date in our respective areas. When clients visit, they know all of us and are comfortable talking with anyone in our office.

The benefits of specialization

We have found that specialization has resulted in our becoming a much more profitable firm. As you develop a particular expertise, you are able to provide a level of service not available elsewhere. You and your client perceive that you are worth more. Consequently, you will be able to command higher fees.

Our client retention is also much better. We seldom have client turnover except for those who are going out of business or are leaving town. We are

The Practicing CPA (ISSN 0885-6931), March 1989, Volume 13, Number 3. Publication and editorial office: 1211 Avenue of the Americas, New York, NY 10036-8775.

working with nicer clients, too. That makes our work more enjoyable.

Specialization has also given us considerable flexibility. We work a flexible nine-hour day, forty-hour week (fifty hours during tax season) and don't take work home with us. It makes no difference to us if some members of our office start early in order to finish work earlier than others. We think clients benefit because we are all working at our most productive times. The net result is happier associates, partners, and clients.

If the benefits of specialization appeal to you, I suggest you try it. Start today, though. Implementation is the key. ☑

—by **M. Dan Howard, CPA,** *Howard & Cunningham, 3302 64th Street, Lubbock, Texas 79413*

To FAX or Not to FAX?

A rapidly increasing number of CPA firms of all sizes is investing in facsimile (FAX) transmission equipment. The firms that first jumped on this new equipment bandwagon tended to be firms with international clients or firms that do a lot of work in association with the legal profession. Now though, the proliferation of FAX machines means that many more clients of CPA firms have their own equipment, and that firms must decide whether they need to follow suit.

According to Greg Carlsted of Dataquest, Inc., a San Jose, California, market research firm, 424,600 FAX machines were shipped in 1987. These had a retail value of $999 million. Although the figures for 1988 are not yet finalized, preliminary estimates are that 864,000 units were shipped.

Dataquest's five-year forecast is for shipments to grow to 2,281,000 units in 1992. The firm estimates that by 1992, there will be 5.8 million FAX machines installed in the business sector. This would reflect a compound annual growth rate, between 1988 and 1992, of over 27 percent in unit shipments.

Having FAX equipment allows you to transmit good quality reproductions of almost any printed material quickly and at reasonable cost. The latest machines use digital technology to transmit an image of your original document over telephone lines. The receiving equipment then prints a copy, usually by a thermal process. As well as improving the quality of FAX copies and the speed of transmitting them vis-à-vis older equipment, the new machines are light in weight (ten to twenty pounds is common for desk-top units), and are about the size of a portable typewriter. The manufacturers have also settled on a universal operating system so that the machines can communicate with each other.

Do you need one? Well, if you frequently send information to clients, other offices or other advisors via an overnight mail service, you can probably justify investing in your own FAX equipment. Perfectly adequate machines are now available for about $1,000, and some industry watchers think that prices will get closer to $500 in the near future.

Some machines are equipped with additional features, however, that add to their cost and complicate their selection. For example, some machines also function as photocopiers, others can transmit larger than letter-size documents, or reduce and transmit these as letter-size sheets. Some units will store up to 100 phone numbers in memory, and allow one-button dialing of frequently called FAX numbers. Other features include a delayed dialing ability which permits the machine to transmit documents at night when the phone rates are lower, automatic feeders, and larger capacity loading trays.

Perhaps, at this point, the following cautionary words might be helpful:

- ☐ Don't buy more machine than you really need. One-button dialing may be useful, but being able to store and access multiple phone numbers or use the machine as a photocopier is probably not a justifiable additional feature for most small firms.
- ☐ The thermal process does not produce a permanent copy. The image may fade with age. You should immediately photocopy FAX materials if you need long-term file copies.
- ☐ Transmitted copy may go astray and end up in some other location than the one intended. Confidentiality, therefore, cannot be assured.
- ☐ Some owners of FAX equipment are receiving unsolicited junk FAX material overnight. This not only uses your toner and paper, but it may make your machine unavailable to someone wishing to send you material.

For infrequent users, where the investment is not justified, or in instances where the intended recipient does not have the equipment, a glance through the Yellow Pages usually uncovers several FAX transmission services. Hotels, airports, and print shops are also likely locations.

Most firms use FAX machines for routine purposes, such as sending documents, letters, financial statements and other data, and urgent correspondence to clients, bankers, and attorneys, or between their own offices. The uses seem to grow. Once you have one in your office, you'll probably wonder how you managed without it. ☑

—by **Donald B. Scholl,** *D.B. Scholl, Inc. P.O. Box 3152, West Chester, Pennsylvania 19381, tel. (215) 431-1301*

A 1988 Portrait of a Public Accounting Firm

For a number of years, *The Practicing CPA* has shared with its readers the highlights of a national survey that gathers a broad range of facts about public accounting practices. The survey is the Practice Management Survey, or PMS, and its purpose is to help owners of accounting firms become better managers by providing them with a financial backdrop against which they can compare their own practices.

State CPA societies sponsor the survey and enlist the support of participating firms. Each year about 3,000 firms respond by completing the survey form, thereby sharing their financial data, billing practices, firm policies, and other facts that are not usually made known. When all the data are assembled, a portrait begins to emerge of the operations of a large cross-section of accounting practices.

A part of the 1988 survey results (reflecting firms' 1987 operations) are presented here. In the following tables, firms are separated into two groups: firms of individual practitioners and firms with two or more owners. The latter group is further divided by size: small, medium, and large. Small firms have revenues of up to $350,000. Medium-size firms have revenues from $350,000 to $950,000, and large firms

Exhibit 1

PROFILE OF
PUBLIC ACCOUNTING FIRMS

		Individual practitioner n = 1544	Nonnational Small[a] n = 432	Medium[b] n = 594	Large[c] n = 443
Financial					
Total net revenue					
	1987:	$150,133	235,399	582,659	1,896,301
	1986:	143,651	220,832	576,267	1,921,387
Firm net income					
	1987:	$ 56,938	104,462	209,052	613,919
	1986:	54,609	94,096	207,216	640,006
Net income per owner					
	1987:	$ 56,938	49,265	74,940	111,966
	1986:	54,609	45,477	74,027	114,590
Total assets[d]					
	1987:	$ 67,354	93,256	258,951	882,691
	1986:	66,178	93,995	258,694	900,640
Owners' equity					
	1987:	$ 46,608	59,481	165,659	591,768
	1986:	43,273	55,297	170,825	621,771
Firm characteristics					
Number of personnel		3.3	5.3	11.0	31.1
Percent owners' income to net revenue		37.9%	44.4%	35.9%	32.4%
Charged hours per person		1,220	1,196	1,292	1,256
Net revenue realized per hour charged		$ 38	37	41	49
		37	35	41	48
Number of days to collect receivables		77	81	100	112
Current ratio		4.7 to 1	4.4 to 1	4.0 to 1	4.0 to 1

[a]Firms with fees up to $350,000
[b]Firms with fees from $350,000 to $950,000
[c]Firms with fees over $950,000
[d]Does not include real estate

have revenues of over $950,000. Data from national firms are not included, so the figures represent local and regional firms of varying sizes. Twenty-three state CPA societies, representing over 3,000 firms, participated in the most recent PMS.

Exhibit II

NET INCOME OF OWNERS
(In cumulative percentages)

Percent earning over:	Individual practitioner	Nonnational Small	Nonnational Medium	Nonnational Large
$30,000 per year	78.4%	83.9%	97.2%	99.5%
$50,000 per year	49.6	45.3	76.5	94.2
$70,000 per year	27.1	16.7	46.9	78.9
$90,000 per year	16.0	4.4	26.0	57.1
$115,000 per year	8.5	1.1	12.2	36.1
$140,000 per year	4.4	0.4	4.7	21.7
$215,000 per year	0.9	0	0.4	4.7
Average income per owner:				
1987:	$56,938	$49,265	$74,940	$111,966
1986:	54,609	45,477	74,027	114,590

Exhibit III

ANNUAL PERSONNEL COMPENSATION

	Individual practitioner	Nonnational Small	Nonnational Medium	Nonnational Large
Managers and supervisors	$32,406	$29,607	$35,554	$41,025
Senior accountants (4–5 years)	$26,018	$23,450	$27,057	$29,777
Staff accountants (0–3 years)	$18,871	$19,087	$20,669	$22,198
Paraprofessionals	$16,513	$15,981	$17,888	$19,480
Clerical	$13,514	$14,190	$16,079	$17,918

A broad overview of the firms

Exhibit 1 captures certain general information pertaining to operating results, incomes, and a few analytical tidbits. Readers may best use this information by comparing their own practices with those of similar size. For example, if an individual practitioner is taking 100 days to collect client billings, this is certainly longer than the norm of 77 days. Perhaps the delay reflects lax collection procedures or a clientele with severe cash flow problems. On the other hand, a large firm with revenues of $1 million would not be unusual in having billings receivable outstanding for 100 days.

Owner income

Perhaps the most-studied data from the PMS is in exhibit 2, which provides a picture of owner income. The way clients sometimes characterize their CPAs' incomes consists more of myth than purchasing power. The PMS has put earnings into a more realistic light. Considering that inflation was in the four percent range during 1987, it is clear that the incomes of most CPAs did not rise by as much as the dollar's buying power declined that year.

Some readers may be mildly surprised by the fact that incomes of individual practitioners usually exceed those of owners in small multi-owner firms. This can occur because firm revenue of a sole practitioner averages nearly one-and-a-half times that of an owner in a small firm. Many of the sole practices have been established longer than many small firms. Owners of small firms are often growth oriented, meaning that "small" is often temporary and transitory, a stopover to becoming a medium-size firm. Lower income is an acceptable, temporary price to be paid while on the road to becoming a medium- and larger-size firm.

Personnel compensation

The largest expense of operating a firm usually is personnel cost. Exhibit 3 provides some useful information to any firm's owner who wonders whether the salary currently being paid to his or her professional staff is competitive. Naturally, employee resignations will give a very graphic indication of when the salary structure needs to be revised, but owners want to be forewarned before a good employee leaves.

Since the PMS data is accumulated from all over the country, different areas often show different compensation levels. Generally, a region with vigorous economic growth will reflect this in higher employee compensation. Employees are paid more in cities with a high cost of living than employees in cities with a low cost of living. Likewise, a major metropolitan area will have higher pay levels than a rural area. These are economic realities the PMS has reconfirmed year after year.

Another important compensation cost is for hiring entry-level accountants. Hiring new personnel is encountered in every firm and is often seen as an indicator of a firm's economic vitality. Hiring comes from growth and turnover, but it should be manageable and predictable. It is important to know how the regional market is pricing new employees.

Exhibit 4 indicates the percentage of firms hiring new accountants with baccalaureate degrees and their starting salaries. The number of firms hiring new personnel increased from 1986, probably reflecting greater economic vitality in several states participating in the PMS. Although economic stagnation often causes hiring to dip, when the stagnation gives way to growth, hiring picks up again. The 1988 PMS found hiring to be generally on the upswing, and salaries paid, slightly higher than the year before.

Promoting the firm

Each firm has its own idea of how best to bring in new clients. One firm may be content to rely on client referrals and on acquaintances made on the country club golf course. Another firm may be more aggressive and hire an advertising agency to air spot tele-

Exhibit IV

STARTING SALARIES
OF ENTRY-LEVEL ACCOUNTANTS

	Individual practitioner	Nonnational		
		Small	Medium	Large
Percent firms hiring new accounting staff—	13.2%	23.5%	48.1%	77.5%
Percent firms offering starting salaries in given ranges...				
Up to $17,999 per year—	51.6%	53.5%	43.3%	17.0%
$18,000 to $19,999	24.2	22.6	30.4	35.6
$20,000 to $21,999	14.4	12.0	14.1	27.2
$22,000 to $23,999	2.3	5.1	7.7	15.2
$24,000 to $25,999	3.0	5.1	3.5	3.2
$26,000 and higher	4.5	1.7	1.0	1.8
Total	100.0%	100.0%	100.0%	100.0%
Average annual starting salary— 1987:	$17,623	$17,490	$18,424	$19,846
1986:	16,988	17,309	17,926	19,388

Exhibit V

MARKETING-RELATED ACTIVITIES
OF FIRMS
(Percent engaging in activity)

	Individual practitioner	Nonnational		
		Small	Medium	Large
Uses media advertising	21.6%	22.3%	23.1%	26.2%
Makes "cold calls" to prospective clients	11.4	10.5	8.1	13.4
Designates someone in firm as marketing director	15.5	13.6	20.2	39.3
Gives added compensation for bringing in new clients	28.9	32.2	38.6	47.2
Distributes firm brochures	29.5	34.1	49.8	70.1
Offers continuing education seminars for clients and others	22.0	25.3	40.4	27.7

vision commercials across the city. Some of the more frequently used methods for generating client prospects are given in exhibit 5.

The concept of marketing is still new to many firms, but regionality comes into play, too. What one firm does in a city often has a ripple effect, causing other firms to do something similar in order to compete. It is generally the pattern that larger firms are more likely than smaller ones to engage in organized promotional efforts.

The question in search of an answer

Last year, when the PMS results were published in the April issue, one question was left unanswered: Was the first-year impact of the Tax Reform Act of 1986 going to substantially increase the percentage of firm revenue from income tax services? Many accountants and others predicted that precisely this would happen because of the passive loss rules, the overhauled, more-inclusive alternative minimum tax, and other complex areas which grew out of the 1986 act.

The 1988 PMS, which would have contained the first full year's efforts of applying the TRA, doesn't indicate anything remotely resembling the predicted result. The most extreme change was in small multi-owner firms: Tax services in 1987 generated 43.9 percent of firm billings compared with 41.9 percent the year before. In 1987, there was a small increase in the billings that tax services generated in sole practices, and in medium-size firms, too. Some small increase has become normal, however, as tax services have slowly garnered more and more of the revenue pie. In contrast, tax services generated 38.4 percent of the revenue in large firms, *down* from 39.3 percent the year before. The talk of large increases in the time needed to advise clients on tax matters and to prepare tax returns was, apparently, overstated.

This was the portrait painted by the 1988 PMS. It is clear that accounting remains a very stable profession, albeit one that doesn't make practitioners rich overnight. Nevertheless, it provides a unique, highly valued service, and returns both tangible and intangible rewards to those practicing it.

We are continually reminded that good accounting practices are not run by good luck but by good management. The profession is becoming more competitive and the public is demanding more accountability. While this all may be in the public good, to get the performances we would like from our firms, it will be evermore necessary to understand the arena in which the firm operates. To quote essayist J. B. Howell, "An acre of performance is worth a whole land of promise."

Firms may participate in the PMS through their state societies. Anyone may purchase the complete PMS report by contacting the Texas Society of CPAs, 1421 W. Mockingbird Lane, Suite 100, Dallas, Texas 75247. ☑

—*by* **Carlton D. Stolle, CPA, Ph.D.,** *Texas A&M University,* **Sanoa F. Hensley, CPA,** *Texas Christian University, and* **Sara A. Reed, CPA, Ph.D.,** *Texas A&M University*

CPA EXAM GRADERS NEEDED

The AICPA's Examinations Division is seeking CPAs and JDs to assist in grading the May 1989 Uniform CPA Examination.

The grading period begins about three weeks after the exam is given and continues for six to eight weeks. Graders must provide a minimum of three seven-hour days each week, excluding Sundays.

For additional information and an application write to:

AICPA
Examinations Division
1211 Avenue of the Americas
New York, NY 10036

1989 National MAS Training Programs Scheduled

Sponsored jointly by Ohio State University and the AICPA, two five-day national MAS training programs will be held on the university's campus, and focus on these topics:

- ☐ *Development of MAS Skills* on June 12–16 is an extensive training introduction. The program is designed to help CPA firm partners and professional staff develop MAS skills, and to begin or expand services in this area.
- ☐ *Advanced MAS Skills* on June 19–23 provides an advanced curriculum covering several important practice areas and skills including strategic planning, business valuations, and MAS practice development and marketing.

For further information on the program, contact Ohio State University, Continuing Education, MAS Training Programs, P.O. Box 21878, Columbus, Ohio 43221-0878. For travel and lodging information, call the program registrar at (614) 292-4320. ☑

Thoughts for Next December

At SB&R, we have experimented with various client acknowledgement ideas over the years. Although we have never sent cards during the holiday season, we have exhibited cards received from clients and others with whom we do business. Obviously, we wanted to show our appreciation. This started me thinking about why people send cards.

Some people send cards to express their appreciation for services they have received over the past year. Some people send them as an expression of friendship, and some, perhaps, in expectation of a future relationship. And then there are people who, for whatever reason, don't send cards.

As I thought about this, it became clear that such gestures mean more to some people than to others. Knowing this, I wondered how we might want to proceed in trying to recognize the good intentions of clients, vendors, and friends of the firm?

One solution is to adopt a "Seasons Greetings" card program. Under this program, we would send a card to everyone on our mailing list. It occurred to me, though, that while some people might regard this as a meaningful expression of our appreciation of the relationship, for some recipients it might only be another piece of mail. Another idea I had was to add a "Seasons Greeting" to our regular quarterly client newsletter. On the other hand, it still seemed that there might be a better and more selective method.

We decided to compile a mailing list from the names of all the people who had sent us cards. Some partners wondered whether such selective mailing would slight other clients. I thought, however, that people have their own reasons for sending or not sending cards, and that we should respect their decisions. After some discussion, we made a New Year's resolution to send cards to each person who sends us one.

I assume that, over the years, partners and principals of our firm will selectively add names to the mailing list. In fact, the list may grow to an unmanageable size, but at least I will be happy in knowing that the original intent was to recognize those people who chose to send us a greeting.

That really is the important message. Let's stop to understand our clients' needs. For those who need to express their appreciation for our professional relationship, this year we shall reciprocate. ☑

—by **John T. Schiffman, CPA,** *Smith, Batchelder & Rugg, Etna Road, HC 61, Box 138, Lebanon, New Hampshire 03766-7501*

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