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Bill What You're Worth

David W. Cottle

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Do you know the No. 1 reason most accountants don't earn enough?

Most firms work too cheaply — and chances are they know it. Pricing your services and billing, for them is one of the most important skills of the successful accountant. Unfortunately, formal education and training courses seldom discuss pricing or billing, and firms rarely discuss pricing in an organized manner, making it all too easy to adopt bad habits and policies that impede profitability.

David Cottle's *Bill What You're Worth* walks you through the most common pricing methods and methodologies, teaches you how to discuss pricing with clients, and offers advice on how to motivate employees to bill what they're worth.

By following the advice in this book, you will be able to:

- Use tools to implement specific value pricing scenarios
- Charge more for those engagements that justify a higher price
- Avoid price disputes and handle misunderstandings in an agreeable manner
- Upgrade your marginal clients' profitability
- Raise your standard charge-out rates, if needed

Plus, this edition includes a new discussion on gauging client satisfaction and the key performance indicators to monitor in order to ensure you are offering top-notch client service.

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Bill What You're Worth, Third Edition

David W. Cottle

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David W. Cottle

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David W. Cottle, CPA, CGMA

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“Personally I’m always ready to learn, although I do not
always like being taught.”—Winston Churchill



Preface to the Third Edition

For over 20 years, it has been my privilege to work with Mark Lloydbottom, FCA, a consultant to accounting firms in the UK. This book has been enhanced by adopting some of Mark's ideas. We have shared ideas and materials over the years and I am grateful to him for allowing me to incorporate some of his material here. I wish to place on record that I value Mark's ability to craft a manual and seminar so that the ideas are easy to understand. As he says, "Our work is a shared journey." We have borrowed ideas from each other and built on each other's work for more than two decades now and I am pleased to include in this new edition several sections inspired by Mark's new book *Deeper—Advanced Practice Management Strategies*, available from www.marklloydbottom.com.



Preface to the Second Edition

When the AICPA asked me to update *Bill What You're Worth* (BWYW), my original intention was to “freshen” the 2003 book by adjusting the examples for inflation; adding references to emails, websites, and the Internet; and using the newest profile firm information from the *Management of an Accounting Practice Handbook*.

But since the first edition of this book was published, two events occurred that I have addressed in this new edition. First, the United States and the world in general are experiencing what some people call the “Great Recession.” The economic recession that began in late 2007 has placed CPAs and their clients under economic stresses of a type and degree not seen in several decades. I have lived and practiced through several earlier recessions, as I am sure most of my readers have. But this is something I have not seen in my lifetime—an event that may change the economic saving, spending, and investing choices of people similarly to the way the Great Depression affected our grandparents. Therefore, chapter 7 covers “Pricing Strategies in a Troubled Market.”¹

The second event is that I coauthored a new book, *Clients4Life: Growing long-term relationships through outstanding service*, with Mark Lloydbottom, FCA, which was published in 2008 by the Institute of Chartered Accountants of Scotland (ICAS).

This collaboration has over 300 pages of ideas on how to be more valuable to clients. When I told my colleague Mark Lloydbottom about the new edition of BWYW, he suggested I add a chapter on how to be worth more, and he also sent me his latest work, *Defining Edge Practice Management Strategies: A Programme of Innovative Strategies for Improving Accounting Firm Management, Marketing and Profitability*, which he had also adapted from our coauthored book.

For over 20 years, it has been my privilege to work with Mark, a consultant to accounting firms in the UK. This book has been enhanced by adopting some of Mark’s ideas. We have shared ideas and materials over the years, and I am grateful to him for allowing me to incorporate some of this material here. I wish to place on record that I value Mark’s ability to craft a manual and seminar so that the ideas are easy to understand. As he always says, “Our work is a shared journey.” We have borrowed ideas from each other and built on each other’s work for two decades now, and I am pleased to include in this new edition chapter 4, “How to Be Worth More to Clients,” based on our joint work, *Clients4Life*.

¹ Editor’s note: See chapter 6 of the third edition.



Preface to the First Edition

Pricing your services and invoicing clients for them is one of the most important skills in making a financial success of your accountancy practice—especially in times of economic stress. However, formal university education almost never covers it; employee training seldom includes it; and even owners of the same firm rarely discuss how to set their prices in an organized manner.

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

However, pricing and invoicing are like accounting or riding a bicycle—they are skills that one must learn. As a result, owners, even in the same firm, often manifest widely different skill levels. Two equally-experienced owners in the same firm, who handle similar work for the same types of clients often yield different results in invoicing clients.

The income you enjoy today and the kind of lifestyle you have when you retire depend on how well you manage your firm. This book will help you in this crucial management area. All CPAs must comply with both the AICPA Code and local state accountancy board regulations regarding fee arrangements. The AICPA rules may be found online.

Benefits of This Book

Follow the advice in this book and you can accomplish the following:

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

How to Make This Book an Investment, Not an Expense

Implement good ideas as soon as you see them; don't wait to finish this book to act. The sooner you act, the better you internalize new ideas and remember them.

Read other books, listen to CDs, and watch DVDs on pricing and invoicing. You'll find a list of some of my favorites in the "Bibliography of Recommended Reading, Listening, and Viewing."²

² Editor's note: Omitted in the third edition.

Expect results. Approach this book with a positive attitude. When you go to a department store, not everything in the store will interest you, but something in that store will. Most books are the same way. Think of this book as a toolkit. Every repair around your home doesn't require every tool in your kit. Sometimes you need the needle-nosed pliers and a screwdriver. But it's nice to have that set of metric wrenches when the specific job that needs them comes along.

This book includes most of the pricing, invoicing, and negotiating tools you need to run a financially successful practice. No book could cover them all because the subject is too large.

To get the most from this book, take my ideas and tailor them to your situation. Keep a pen or highlighter handy. When something sparks an idea, write it down before you forget it. Use the margin of the page if necessary. Ask yourself: How does this apply to my practice, my clients, and my situation? How can I make a few changes to this idea and make it work for us? Somewhere in this book, you will find valuable ideas to enhance your practice.

Keep writing. The more notes you take, the more value your book has for you in the future. People who take notes retain more of what they read.

I hope you get a lot out of your investment in this book.

Acknowledgments

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

I've done a lot of research for this book. I have studied the pricing of accounting, consulting, and advisory services since I first hung out my shingle decades ago. I still learn new things all the time. This book represents the truth as I see it today, not the "Truth" with a capital "T."

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

—Buddha

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

Lots of my ideas come from my clients. I have been privileged to work with about 25 of the 100 largest CPA firms in the United States, and about 15 of the largest 50 in the United Kingdom. Every big firm is a small firm that got it right. And I've worked with some extremely profitable small firms with fewer than 10 total personnel, and learned from these boutique firms also.

I covered parts of this book in several of my earlier books, including the earlier editions of this book. This book also contains material from my book *Clients4Life*, co-authored with Mark Lloydbottom, FCA, published by the Institute of Chartered Accountants of Scotland, and also Mark's book *Deeper—Advanced Practice Management Strategies*.

I am especially indebted to L. Ron Hubbard, the 20th-century American writer and philosopher, from whose works I have learned a great deal about human nature and motivations.




Introduction

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

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

But people problems remain the same generation after generation—partner compensation, recruiting, client relations, marketing, and so forth—because people don’t change. That’s why we can get valuable advice for living from some very old books like the Holy Bible. Technology changes; people don’t!

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

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

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

- They act as if they need their clients more than their clients need them.
- They have the attitude that they don’t deserve to make a lot of money.
- They believe they have to justify everything they do. I call this “playing defense instead of offense.”
- They have the attitude that something has to come hard to be worth anything.

- They think they have to work 60 or more hours a week during the busy season to be successful.
- They feel there is something immoral about charging more than standard.

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

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

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

This book will help you adjust your attitude.

Once Upon a Time in Ukraine...

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

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

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

Times were tough in Ukraine. This was the early 1990s and the same socialists who ruined the Soviet Union were still in charge and people struggled to survive.

One little old man, who stood about 5 feet, 4 inches tall, stood behind a rickety table where he displayed what we thought were assorted pieces of scrap metal. When we looked closer, it was odd metal bits such as nuts, bolts, angle iron, brackets, and what all. Judging from his three-day growth of grizzled beard and well-worn clothes, the old man scavenged in junkyards for odds and ends to sell at the market.

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

The old man shyly looked up at Sheila (who is 5 feet, 9 inches tall) and timidly held up two fingers with a questioning look on his craggy face. I read him to mean, "Is two okay?"

Sheila looked at me. "Do you think that is 200,000 coupons or two dollars?" She didn't care about the price; she just wanted to know what kind of currency to pull from her purse.

I shrugged. "I don't know. Why don't you ask?" The old man spoke no English.

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

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

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

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

I could almost read his mind, thinking "She didn't even haggle! Has this crazy tourist never been to a market? I can't believe she took my first offer! Wait until I get home tonight and tell my wife; she'll never believe the sucker I found. Oh, wait a minute.... When I tell my wife, she'll yell at me for ripping off a guest in our country. I'll never hear the end of it." (I should tell you Ukrainian people were invariably polite and among the most hospitable people I have known, and I have traveled to over 70 countries.) He had started with a ridiculously high (to him) asking price so he had room to negotiate.

He felt so guilty at overcharging Sheila that he reached into a bag beneath the table and brought out a collapsible plastic drinking cup and handed that to Sheila along with the wrench.

From this story, there are two important lessons you can apply to your CPA practice.



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

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



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

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


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

Now, as radio commentator Paul Harvey used to say, "... the rest of the story."

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


His two fingers followed by a bunch of zeroes was 20,000, not 200,000. He and Sheila had valued the wrench differently by a factor of 10!

From this, you can learn another important lesson to apply to your practice.

 **Key Point:** *Cattle's Observation*—Almost all buyers would pay more for the things they buy. Sometimes a lot more.

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

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

 **Key Point:** All value is subjective. Goods and services have no inherent value. As my mother used to say, “A thing is only worth what people are willing to pay for it.”


Why Some Accountants Earn Much More Than Others

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

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

- Is the accountant who makes \$500,000 a year twice as smart as one who makes \$250,000? Not likely.
- Does the \$500,000 accountant work twice as hard? No way!
- Has the \$500,000 accountant been in practice longer and thus has a head start? Sometimes, but not always.

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

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

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

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

Three Top Reasons Accountants Do Not Earn Enough

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

Disregarding what any of your fellow owners' chargeout rates may be, could you personally invoice and collect \$20 per hour more for your own time?

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

What's your answer? Could you charge \$20 per hour more?

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

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

The typical answers average between 35 percent and 70 percent.

What's your answer?

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

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

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

A Word About Terminology

For a profession whose stock in trade is accuracy, we accountants can be quite imprecise in the way we use certain terminology.

For example, CPAs often use the words "chargeable" and "billable" interchangeably. We use "fee" and "price" interchangeably. And we use "bill" and "invoice" interchangeably. And sometimes, we use "bill" and "fee" to mean the same thing. Yet each of these terms can be different.

- *Charge* as a noun can mean "a debit entry to work in progress (WIP)" or "the price for a particular service or engagement."
- *Billable* can mean "chargeable to the client's WIP" or "to be included in the client's invoice."

- *Bill* as a verb can mean “debit it to the client’s WIP” or “send the client an invoice.”
- Yet *bill* as a noun can mean “price” or “invoice.”
- *Fee* can mean “price” or “standard rate debited to WIP.”
- *Fees* can mean “sales” or “standard rates times chargeable hours.”

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

- I avoid the word “billable,” using instead the word “chargeable.”
- I use “standard chargeout rate” in preference to “standard billing rate.”
- I use “invoice” in preference to “bill.”
- I use “price” in preference to “fee” when referring to the amount that is invoiced to a client.
- Whenever you read *fee* or *fees*, it means “standard chargeout rate(s) times chargeable hours.”

The “Glossary” includes definitions of all terms that might be confusing.

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Chapter 1

Pricing Methods in the CPA Profession

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

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

Variations of *cost-plus* pricing are the most common in the profession. The CPA firm starts with its direct labor costs, adds an overhead factor and a profit factor, and assigns *standard chargeout rates* to each person in the firm based on the individual's hourly pay. *Owner* rates are set subjectively somewhat higher than the rates of the most experienced employees. A large local firm might set its newest partner's rate at 40 percent above the firm's highest manager. A medium-sized or smaller local firm might set its lowest partner rate 30 percent above the highest manager. Other partners would go up from there.

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

¹ All CPAs must comply with both the AICPA Code and local state accountancy board regulations regarding fee arrangements. The AICPA rules may be found at www.aicpa.org/Research/Standards/CodeofConduct/Pages/et_302.aspx and www.aicpa.org/Research/Standards/CodeofConduct/Pages/et_503.aspx. Links for state jurisdictions may be found at www.aicpa.org/research/externallinks/pages/stateboardsofaccountancylinks.aspx.

Results pricing is the practice of agreeing in advance to invoice the client based on the results you obtain, regardless of the amount of chargeable time invested. Commissions and contingent prices are examples of results pricing.

In value pricing, the CPA may wait until he or she finishes the engagement to set the price. That way, the CPA (and the client) can evaluate the CPA's contribution and invoice accordingly. Most CPAs have done this—at least when evaluating their contribution downward—for many years.

Key Point: To clients, every price is a value price. Clients always adopt a value pricing approach. Unless they feel they received value from you that was greater than the price, they will be unhappy with your invoice.

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

Types of CPA Firm Services

Accounting firms provide three types of service:

- Specialist and niche services
- Extension and advisory services
- Compliance services

Specialist/Niche Services

Specialist and niche services set a firm apart and provide opportunities to promote service(s) not offered by other local firms. These services may be to a particular industry, such as the health care sector, or they may be a specialty delivered across a range of clients (for example, estate planning, financial services, and so on).

With specialist and niche services, the firm commits to offer services beyond the traditional compliance offerings. These services entail special expertise and a dedication to service delivery. Such specialization commits the firm to additional personnel training, increased research and studying, as well as networking and other time commitments. These services have marketplace appeal and good pricing potential. They can often be sold with fixed pricing, results pricing, or value pricing.

Sometimes a specialist and niche service follows from compliance services. It is in these moments that you impress the client with your expertise and position yourself as a credible adviser who can bring solutions to clients in other areas of need.

Extension and Advisory Services

These services relate to what a client could or should do in the future. They relate to future planning and may encompass knowledge gained during compliance services.

Advisory services are not exclusively driven by compliance expertise. They have a wider scope because they do not depend solely on technical knowledge. Not all firms have succeeded in introducing advisory services.

Extension services are those which clients automatically associate as being provided by their accountant. These services extend the service into the present operating environment of the client. They include bookkeeping and other record keeping, computer and systems consulting, attendance at management meetings, estate planning, financial planning, and so forth.

What about *Type 2* or *value-added services*? These are just two of the names used to describe non-mandatory services. The term *value-added* implies that compliance services do not add value, which is not true. Clients entrust their tax affairs to their accountant, believing he or she will keep taxes down to the lowest amount consistent with the law.

Some extension services, such as bookkeeping, are quite similar to compliance services and are commonly sold under cost-plus pricing. Other extension services such as estate or financial planning might be better sold using fixed prices, results pricing, or value pricing.

Compliance Services

CPAs owe a debt of gratitude to governments, tax authorities, and regulatory bodies whose requirements bring clients back year after year. Some call these services *tax*, *audit*, or other *compliance* services. These services are normally sold with cost-plus pricing. Tax preparation is usually sold with a base of cost-plus and an added element of value pricing.

Having looked at services, let us consider the two key roles the accountant plays in service delivery—expert and adviser. Some CPAs default to one role with limited incursions into the other, while others specialize in only one.

Expert

We use *accountant* and *expert* as interchangeable terms. All your compliance services are delivered by you as an expert, and clients recognize you as the expert in these fields.

Your technical expertise and knowledge of compliance-related planning services position you as an expert. You have extensive, up-to-date knowledge and can provide solutions to your clients' problems. You tell clients what is best for them and recommend actions to take.

Although you could view this as advisory, this advice is integral to the compliance service itself (and not a separate advisory service) in the context of compliance services. Indeed, you must add advice to your compliance service offering to serve your client well. Otherwise, you leave the job half done.

With compliance services, you remain in control of the process and have the expertise to meet the clients' needs—you are the expert.

Adviser

The adviser role differs from that of an expert, although in practice no clear line separates them.

If you do not offer these expanded services, you have failed your clients.

Can you be an expert only? Yes, if you provide specialist and niche services or compliance services with minimal advice.

Can you be an adviser only? No. You develop your position as adviser from your compliance responsibilities. With compliance services, your primary role is that of expert.

Can you be both expert and adviser? Yes.

There are several concepts discussed in the text that follows that can help you price your services effectively. These concepts include cost-driven prices versus value-driven prices, pricing and risk, using chargeout rates as a benchmark, and investment versus value.

Cost-Driven Prices Versus Value-Driven Prices

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

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

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

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

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

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

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

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

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

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

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

The overwhelming majority of accounting practices record all time charges to clients as *work-in-progress (WIP)* at an amount based on standard chargeout rates for each person.

When engagements are completed and invoiced, any difference between the standard fee amount and the final amount invoiced is recognized as a write-down or *write-up*. Value-driven professions usually record revenue only when they send invoices to clients.

Pricing and Risk

Cost-plus pricing transfers risk to the client. This has advantages and disadvantages. Although accountants prefer to have clients take the risk for the job going over budget or for unforeseen engagement problems (which is what cost-plus pricing does), clients prefer the accountants take the risk. After all, accountants are the professionals and they should know what they are doing.

Profit comes from risk. No risk, no reward.

In return for the client assuming the risk, the accountant pays the client a reverse risk premium by agreeing to accept only the standard rate. This puts a comfortable floor beneath the CPA, but it also creates an artificial ceiling. This idea is manifested in national averages of CPAs realizing around 85 to 95 percent of standard. Larger local firms tend to have lower realization around 85 percent (and higher standard rates), while smaller local firms tend to have higher realization around 90 percent and lower standard rates. I have seen small practitioners with realization of 96 percent to 99 percent.

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

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

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

Using Chargeout Rates as a Benchmark

One of my client firms in the East had net sales of 99 percent of its standard fees. Another client firm on the West coast had net sales of only 82 percent of its standard fees. Was the eastern firm better managed? No, because the western firm's partners earned twice as much as the eastern firm's. Why? Because the western firm set its standard rates 50 percent higher than those of the eastern firm, so even though the western firm's write-downs appeared excessive, its effective chargeout rates were significantly higher than those of the eastern firm.

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

Example: The eastern firm whose net sales were 99 percent of standard was a cost-driven firm. It was also much smaller than the western firm.

But some firms set optimistic, *best-case* standard chargeout rates. These firms base their standard rates on their highest value services. For most routine mandatory services such as bookkeeping, compilations and reviews, these firms would not expect to realize best-case rates because the market for such services will not support the higher rates. They plan for substantial write-downs (sometimes as high as 20 percent to 25 percent) over the course of a year. Such write-downs represent the CPA firm's pricing decisions which are planned in client negotiations for routine services before an engagement begins. Net sales (that is, amounts invoiced) represent the true production of these firms because that is what the firms expect to earn before doing the work, and net sales are the benchmark by which the firms judge their management effectiveness. We refer to this ambitious pricing philosophy as *target-driven*—the standard rates are the ideal scene that firms target, knowing that they will not achieve their ideal in every case.

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

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

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

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

Investment Versus Value

Compare the following terms, and consider the contrasts:

Cost	Benefit
Effort	Results
Input	Output
Investment	Return on investment

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

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

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

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

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

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

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

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

There is a myth that the amount on a CPA's time-keeping system indicates the fair price. The reality is that the amount on a time-keeping system indicates only what the firm invested in an engagement at standard rates. That amount has little to do with the value of the work to the client.

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

Cost-plus pricing creates an inevitable conflict of interest with clients. Cost-plus pricing means increasing the client's costs to increase the CPA's profits. In 12 years of accounting practice and over 30 years as a profitability adviser, I have never seen a CPA firm stretch their hours to make more money. Nevertheless, clients sometimes believe there is a risk their accountants will do so.

With today's emphasis on downsizing, reengineering, and doing more with less, cost-plus pricing is the exact opposite of efficiency. It creates what economists call *perverse incentives* on CPA efficiency. IBM once had a similar problem when it paid its programmers by the line of code they wrote. The programmers responded by increasing the number of code lines at the expense of efficiency.

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

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

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

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

- Cost-plus pricing focuses on efforts, not results.
- Cost-plus pricing doesn't reward creativity and innovation; it rewards inexperience and inefficiency, even incompetence.
- Cost-plus pricing has its advantages. It's easy to explain to clients. It's easy to administer. It's easy to defend. And it is a great retail cost-accounting tool.

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

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



Chapter 2

How Much Do You Really Earn?

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

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

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

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

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

The profile firm I selected was the middle firm of the five different-sized profile firms presented in the 2010 edition of the *MAP Handbook*. It has three owners, 14 technical staff, and 3.5 full-time equivalent (FTE) support personnel for a total of 20.5 people who generate \$2,165,800 of **net sales**. Note that some of the terminology in the *MAP Handbook* has been changed to conform to the terminology used in this book. For more information, see the Glossary.

The 2014 edition of the e-MAP handbook does not include enough financial information to analyze in detail any of the profile firms currently presented, so I used the data from the second edition of this book.

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

Exhibit 2-1: Profile Firm Income Statement

	Profile Firm	Your Firm
Revenue		
Standard fees	2,393,150	
Billing adjustments and bad debts	(227,350)	
Net fees	2,165,800	
<i>Direct Expenses</i>		
Salaries—technical employees	636,000	
Salaries—paraprofessional employees	—	
Salaries—support employees	108,500	
Total salaries	744,500	
Consulting—unallocated	16,000	
Data processing—unallocated	43,300	
Total direct expenses	803,800	
<i>Indirect Expenses</i>		
Personnel	157,000	
Facilities	173,000	
Marketing	41,000	
Other operating expenses	113,000	
Nonoperating expenses	27,000	
Total indirect expenses	511,000	
Net income (using traditional proprietorship/partnership accounting)	\$ 851,000	
Profit margin (partnership GAAP)	39.29%	

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Exhibit 2-2: Profile Firm Balance Sheet

	Profile Firm	Your Firm
Assets		
Cash	\$ 30,000	
Receivables—invoiced	430,000	
Work in progress	162,000	
<i>Allowance for doubtful accounts and billing adjustments</i>	(62,000)	
Partner's and employees' accounts receivable	—	
Other current assets	5,000	
Total current assets	565,000	
Building and leasehold	25,000	
Furniture and equipment	150,000	
Autos	—	
Accumulated depreciation	(100,000)	
Other assets	5,000	
Total assets	\$ 645,000	
Liabilities		
Notes and loans payable—bank	\$ 25,000	
Notes and loans payable—partners	—	
Notes and loans payable—other	—	
Payables and accruals	30,000	
Total current liabilities	55,000	
Long-term debt	50,000	
Total liabilities	105,000	
Capital accounts	540,000	
Total liabilities and capital	\$ 645,000	

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Exhibit 2-3: Profile Firm Analysis of Fees

Level of Personnel	Number of Persons	Total Hours per Person	Extended	Average Chargeable Hours per Person	Extended	Standard Chargeout Rate	Standard Revenues
Owners							
Executive and management consulting services	1.0	2,400	2,400	1,200	1,200	175.00	\$ 210,000
Audit	1.0	2,400	2,400	1,400	1,400	140.00	196,000
Tax	1.0	2,400	2,400	1,400	1,400	140.00	196,000
Total partners	3.0		7,200		4,000	150.50	602,000
Technical employees							
Staff (1 year)	2.0	2,250	4,500	1,600	3,200	67.00	214,400
Staff (2 years)	3.0	2,250	6,750	1,650	4,950	73.00	361,350
In-charge (2 years)	3.0	2,250	6,750	1,650	4,950	73.00	361,350
In-charge (3 years)	2.0	2,250	4,500	1,650	3,300	77.00	254,100
In-charge (3 years)	3.0	2,250	6,750	1,650	4,950	79.00	391,050
Manager (6 years)	1.0	2,250	2,250	1,600	1,600	104.00	166,400
Total technical employees	14.0		31,500	1,639	22,950	76.19	1,748,650
Total owners and technical employees	17.0		38,700		26,950		2,350,650
Support personnel							
Administrative assistant	1.0	2,100	2,100	400	400	50.00	20,000
Other	2.5	2,000	5,000	200	500	45.00	22,500
Total support personnel	3.5		7,100		900		42,500
Total technical and support employees	17.5		38,600		23,850		1,791,150

(continued)

Level of Personnel	Number of Persons	Total Hours per Person	Extended	Average Chargeable Hours per Person	Extended	Standard Chargeout Rate	Standard Revenues
Total all personnel	20.5	2,234	45,800		27,850		2,393,150
Less write-downs							(227,350)
Net sales							\$2,165,800
Realization = net sales / total standard revenues							90.50%

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The Problem with Partnership GAAP

One quirk of proprietorship and partnership financial reports is that they reflect all owners' compensation as profits, which is correct under generally accepted accounting principles (GAAP), but can nevertheless be misleading.


Example: Some years ago, a good friend and client asked me, "What is a normal profit margin in my city? I think my profit margin is too low."

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

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

To which I responded, "Precisely!"

That was the point I wanted to make.

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

The Ratio of Employees to Owners

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

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

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

But look at the profile firm. Right now, it shows a margin of 39.3 percent. If they promote their manager to partner with no change in underlying compensation and no other change in the performance of the firm, expenses decrease by the manager's \$62,000 annual salary (ignoring the effect of payroll taxes), nominal "profit" increases by \$62,000 to \$ 913,000, and "profit margin" increases to 42.2 percent, an improvement of about five percent in the firm's profit margin. At the same time, net income per owner declines by \$55,417 (19.5 percent) from \$283,667 to only \$228,250. That is why profit margin can mislead the reader who makes year-to-year comparisons.

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

The Salaries of Owners

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

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

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

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

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

Interest on Owners' Capital

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

Example: One of my clients paid 10 percent interest on owners' capital for many years—regardless of the prime rate, which could be anywhere between 5 percent and 15 percent. And a small firm paid owners 6 percent interest on their capital.

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

Pricing Philosophy

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

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

The Financial Analyst's Dilemma: GAAP Versus Economics

The preceding discussion illustrates that accounting firms can differ in the following ways:

- Ratio of employees to owners
- Method of compensating owners
- Capital structure
- Pricing philosophy

Partnership accounting (which shows owners' compensation as profits whether it came from invested capital, labor, or entrepreneurial skill) exacerbates those differences. It is often futile to compare different firms' salaries, chargeout rates, or other operating information because it amounts to comparing "three grapes with four melons."

Fortunately, Ronald G. Weiner, co-managing partner of Perelson Weiner LLP CPAs in New York City, developed a way to take these different factors and convert them to a common model so that the results from different firms can be compared. Back in the 1980s, Weiner noticed that most firms establish their standard chargeout rates based upon a multiplier of employee salary. He used this fact to establish a standard pricing and cost system, which can be used to compare the results among firms.

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

Step 1: Convert Owners' Salaries to Fair Market Value

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

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

Employee's base annual compensation	\$ 48,000
Divided by estimated chargeable hours	<u>1800</u>
Equals cost per chargeable hour	\$ 26.67
Times chargeout multiple	<u>× 3</u>
Equals standard chargeout rate	<u>\$ 80.00</u>

This is the old *2-percent rule*. Eighty dollars is 2 percent of the employee's \$4,000 monthly base pay. In Paul Professional's case, if you divide the \$80 chargeout rate by the \$48,000 annual compensation, you get an *annual* chargeout multiple of .001667.


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

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

Employee's base annual compensation	\$50,000
Divided by estimated chargeable hours	<u>1600</u>
Equals cost per chargeable hour	\$ 31.25
Times chargeout multiple	<u>× 3</u>
Equals target chargeout rate	<u>\$ 93.75</u>
Actual chargeout rate used	<u>\$ 95.00</u>

Dividing the \$95 rate by the \$50,000 annual compensation yields an actual chargeout multiple of .0019.

This firm, like Paul Professional, also uses a so-called *three-times chargeout multiple*, yet its annual multiple was 14 percent higher—.0019 compared to Paul's .001667. The difference is that the second firm is divided by 1,600 chargeable hours and rounded upwards, while Paul divided by 1,800 and did not need to round.

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

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

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

If you invert Paul Professional's chargeout rate formula for employees and divide Paul's own chargeout rate by his .001667 employee multiplier factor, you can approximate the fair market value of Paul's compensation. Thus, if Paul's rate is \$225, divide that by .001667 to

get a fair market salary of about \$135,000. That might or might not approximate the practice's replacement cost to hire Paul.

Exhibit 2-4, "Profile Firm Employee Chargeout Multiples," shows the chargeout multiples for the profile firm.

Exhibit 2-4: Profile Firm Employee Chargeout Multiples

Level of Personnel	Compensation			
	Standard Chargeout Rate	Including Overtime	Base Pay	Chargeout Multiple
Technical employees				
Accountant (1 year)	\$ 67	\$ 40,000	\$ 35,632	0.001880
Staff (1 year)	67	40,000	35,632	0.001880
Accountant (2 years)	73	43,000	38,304	0.001906
Accountant (2 years)	73	43,000	38,304	0.001906
Accountant (2 years)	73	43,000	38,304	0.001906
In-charge (2 years)	73	44,000	39,195	0.001862
In-charge (2 years)	73	44,000	39,195	0.001862
In-charge (2 years)	73	44,000	39,195	0.001862
In-charge (3 years)	77	46,000	40,976	0.001879
In-charge (3 years)	77	46,000	40,976	0.001879
In-charge (3 years)	79	47,000	41,867	0.001887
In-charge (3 years)	79	47,000	41,867	0.001887
In-charge (3 years)	79	47,000	41,867	0.001887
Manager (6 years)	104	62,000	55,229	0.001883
Total technical employees	\$1,067	\$636,000	\$566,544	0.001883
Support employees				
Administrative assistant	\$ 50	\$ 36,000	\$ 35,488	0.001409
Other	45	29,000	29,000	0.001552
Other	45	29,000	29,000	0.001552
Other	45	14,500	14,500	0.001552
Total support employees	\$ 185	\$108,500	\$107,988	0.001552

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

For the profile firm, I use .001883, the manager's multiple, shown in exhibit 2-4, which also happens to be the multiple for all technical employees.

Exhibit 2-5, “Employee Chargeout Multiples Form,” is a form you can use to calculate your employee chargeout multiples. For part-time employees, multiply their hourly compensation by 2,080 hours to figure the equivalent compensation for a full-time person.

Exhibit 2-6, “Profile Firm Fair Market Value of Owners’ Salaries,” calculates owners’ salaries for the profile firm.

Exhibit 2-5: Employee Chargeout Multiples Form

Level of Personnel	Standard Chargeout Rate	Base Annual Compensation	Chargeout Multiple (Column 2 Divided By Column 3)
Technical employees			
Total technical employees			

Exhibit 2-6: Profile Firm Fair Market Value of Owners' Salaries*

Executive/Management Consulting Service (MCS) Owner		Profile Firm
1	Executive/MCS owner chargeout rate	175.00
2	Divide by employee billing multiple	0.001883
3	[1 ÷ 2 =] Average fair market value salary of owner	92,933.62
Tax Owner		Profile Firm
1	Tax owner chargeout rate	140.00
2	Divide by employee billing multiple	0.001883
3	[1 ÷ 2 =] Average fair market value salary of owner	74,346.90
Audit Owner		Profile Firm
1	Audit owner chargeout rate	140.00
2	Divide by employee billing multiple	0.001883
3	[1 ÷ 2 =] Average fair market value salary of owner	74,346.90
Average		Profile Firm
1	Average owner chargeout rate	150.50
2	Divide by employee billing multiple	0.001883
3	[1 ÷ 2 =] Average fair market value salary of owners	79,922.91
4	Times number of owners	3.00
5	[3 × 4 =] Total owners' salaries	239,768.74
Sample Firm Market Salaries		Fair Market Value Salaries
Executive/MCS owner		145,512.00
Tax owner		98,247.00
Audit owner		80,600.00
		324,359.00

*Number may not calculate exactly due to rounding.

The profile firm's average owners' salaries calculate at \$79,923. This means that—based on their chargeout rates—they are telling the world that clients could hire people with the owners' level of experience for \$79,923 in the open market.

This seems low to me. In most areas of the United States, senior-level financial executives comparable to typical owners of CPA firms should command salaries of \$100,000 or more. One executive search firm website estimated that a tax senior manager or director with an MBA and 10 years of experience with a typical smaller CPA firm should earn \$92,500 to \$131,250. If so, then the profile firm's owner chargeout rates are too low, even based on their current chargeout multiple.

In Paul’s case, inverting his \$225 chargeout rate yields a fair market salary that approximates the replacement cost of his services, because he had about 10 years of experience at the time. But that is not always the case, especially with the profile firm.

Usually, I expect a newly promoted owner to make about 30 percent more than he or she did as a manager. The profile firm’s manager makes \$62,000, indicating that the audit owner should make at least \$80,600 if he or she is newly promoted. Assume \$80,600 as the fair market value of the audit owner’s salary. This would indicate a standard chargeout rate of \$152 using the firm’s current chargeout multiple.

Use exhibit 2-7, “Fair Market Value of Owners’ Salaries Form,” to calculate owner salaries for yourself and your fellow owners using your employee chargeout multiple and your owners’ personal chargeout rates. If you also find the calculated salaries lower than the replacement cost in your area for owner-level accountants, use the fair market value for your area.

Exhibit 2-6 shows that the first \$324,359 of so-called profit the firm earns is the economic cost of hiring their owners. Any additional income owners earn (or shortfall, if income doesn’t cover a fair salary) is dependent upon the effectiveness of their management and marketing efforts.

Exhibit 2-7: Fair Market Value of Owners’ Salaries Form

		The Owner Personally	Your Firm
1	Average owner chargeout rate		
2	Divide by employee billing multiple		
3	[1 ÷ 2 =] Average fair market value salary of owners		
4	Times number of owners	N/A	
5	[3 × 4 =] Total owners’ salaries	N/A	

Step 2: Convert Owners’ Capital to Financial Equivalents

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

Exhibit 2-8, “Profile Firm Interest on Capital,” calculates interest for the profile firm with space for your firm. (If you don’t know your average capital, use the averages of your capital today and 12 months ago.)

Exhibit 2-8: Profile Firm Interest on Capital

		Profile Firm	Your Firm
6	Average accrual-basis capital	540,000	
7	Times interest rate	10%	
8	[6 × 7 =] Interest on capital	54,000	

Step 3: Convert Net Sales to Standard Revenue

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

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

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

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

If you don’t know your standard revenue, estimate it by working backward from an estimate of your percentage write-downs.

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

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

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

Exhibit 2-9: Profile Firm Standard Revenue

		Profile Firm	Your Firm
9	Net sales	2,165,800	
10	Add write-downs (deduct write-ups)	227,350	
11	[9 + 10 =] Standard fees	2,393,150	

Weiner concludes:

By adding allowances for partners' salaries and interest on capital to firm costs and expenses, all costs can be made comparable. Expressing these costs as a percentage of standard time charges yields the cost to produce \$1.00 of service. To the extent technical salaries vary from one-third of standard time charges, it can only be due to the pricing structure or productivity as measured in chargeable hours. Also, to the extent other costs (exclusive of technical salaries) vary, it constitutes a deviation in the overhead rate which can then be compared against other firms and periods. To the extent you cannot bill and collect your standard time charges, this should be viewed as a bottom line cost and not included in overhead since it costs the same to provide a dollar's worth of service whether you collect it or not.¹

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

Analyze the Profile Firm

With owners' salaries, interest, and standard fees calculated, we can now compare the operations of any firms. So, let's evaluate the profile firm using the Weiner method. Exhibit 2-10, “Profile Firm Profitability Analysis,” shows the calculations for the profile firm with space for your firm.

¹ Ronald Weiner, “One-Third Labor, One-Third Overhead: What Happened to One-Third Profit?” presented at the 1989 AICPA National Practice Management Conference East in Atlanta, Georgia.

Exhibit 2-10: Profile Firm Profitability Analysis

		Profile Firm	Your Firm
12	Standard fees	2,393,150	
13	Economic expenses:		
13a	Technical employees' salaries	636,000	
13b	Add owners' salaries [refer to line 5]	324,359	
13c	Total technical salaries	960,359	
13d	Percent of standard fees	40.13%	
13e	Support employees' salaries	108,500	
13f	Other direct expenses	59,300	
13g	Indirect expenses	511,000	
14	Add interest on capital [refer to line 8]	54,000	
15	[13a through 13g + 14 =] Total economic costs and expenses	1,693,159	
16	[15 ÷ 12 =] Percent of standard fees	70.75%	
17	[12 – 15 =] Economic profit on standard fees	699,991	
18	[17 ÷ 12 =] Percent of standard fees	29.25%	
19	Write-downs [refer to line 10]	227,350	
20	[19 ÷ 17 × 100 =] Percent of economic profit	32.48%	
21	[17 – 19 =] Economic income (entrepreneurial results)	472,641	
22	[21 ÷ 12 × 100 =] Percent of standard fees	19.75%	

Note that the Weiner model expresses profits (*economic income*) as a percent of standard fees. GAAP accounting expresses profits as a percent of net sales. As a result, the revenue denominator for percentage calculations for the Weiner model is different from traditional partnership accounting. The profile firm's *profit margin* shown the traditional way was 39 percent. After allowing for owners' salaries and interest, their entrepreneurial results (true economic income) was just under 20 percent.

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

Where did the profits go? The profile firm's total costs were 71 percent, 4 percent too high. Why? Either their *utilization* was too low or their prices (based on the effective charge-out rate) were too low. Which is it? Or is it a combination of both? We will examine that issue later. But one clue is that technical salaries shown on line 12c are 40 percent of standard fees, not 33 percent.

Line 16 shows that the profile firm earned \$699,991 before write-downs (29 percent of standard fees) and then lost 32 percent of its profit to write-downs (line 19).

Analyze Firm Overhead

The “one-third, one-third, one-third” paradigm assumes that overhead equals salary cost. Exhibit 2-11, “Profile Firm Overhead Analysis,” compares overhead and salaries of the profile firm. As you will note, overhead costs are 76.30 percent of salaries. Does the profile firm show excellent cost-management skill? Not necessarily. The “overhead equals salaries” paradigm is only an approximation; the relationship was never meant to be exact. Over many years of analyzing the financial operations of hundreds of CPA firms, my experience has been that overhead is usually much less than technical salaries. But the profile firm could be skimping on marketing, training, facilities, or other operating areas. Variances in overhead ratios also arise from regional differences between cities, suburbs, and rural areas, for example.

Exhibit 2-11: Profile Firm Overhead Analysis

	Profile Firm	Your Firm
Total economic costs and expenses [refer to line 15]	1,693,159	
Less technical salaries [line 13c above]	960,359	
Equals overhead cost	732,800	
Overhead costs as percent of salaries	76.30%	

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

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

Analyze Firm Write-Downs

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

In fact, the firm can usually allocate write-downs directly to the responsible PIC. Therefore, I recommend that you view write-downs as a dollar cost and show it as a separate line item like any other cost, rather than as a percentage reduction of standard fees.

Once an engagement is complete, all costs to create that service are sunk costs—nonrecoverable. That means every dollar the firm invoices is 100 percent profit. In this respect, write-downs are the most controllable cost because the amount to invoice is discretionary

with the PIC. Granted, there are marketing, competitive, and client relations aspects to consider. Nevertheless, write-downs are controllable. Evidence of this is that different PICs in the same firm often have different realization on their respective ledgers even though the PICs perform the same type of services for the same type of clients.

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

Exhibit 2-12: Profile Firm Economic Income Analysis

	Profile Firm	Your Firm
Net income (traditional method)	851,000	
Less owners' salaries	(324,359)	
Less owners' interest	(54,000)	
Economic income (entrepreneurial results)	472,641	

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

The Key to Improving Profitability

The classical economist said, "Lower costs to increase profit."

Many accountants who need more profitability look first at costs by asking, "How much are salaries, rent, training, telephone, publications, and so on?" Then, they ask, "What expenses can we cut so we make the right amount of money?" The reason is simple: At first blush, it appears that a cost reduction increases profits by the same amount. "A penny saved is a penny earned," as Benjamin Franklin said. This is especially true in times of economic stress because costs are more within the CPA's control than creating additional revenue.

Yet this cost-cutting strategy has only limited utility. Increasing profits by reducing costs is a tactic that runs out of steam. No matter how well the firm is managed, it will reach a certain irreducible limit.

Key Point: Expenses result from business activity—and these activities are an indicator of business health. Consider that it is possible to eliminate all expenses by closing the business!

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

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

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

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

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

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

These cost-control measures are meant to improve efficiency and reduce costs without adversely affecting service levels. Unfortunately, they achieved neither of these goals.

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

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

Prospects who visit the firm’s website find it still has last year’s due dates on the “due dates” page and the firm loses credibility.

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

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

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

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

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

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

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

When is the Top Line Not the Top Line?

Notice that Exhibit 2-10, “Profile Firm Profitability Analysis,” begins with standard revenue. That is the financial top line. But sometimes the top line is not really the top line.

Let's look at another top line: total time capacity.

My profile has 3 partners, 14 professional staff, 3.5 administrative staff, and annual net sales of \$2,165,800.

Position	Number of Personnel	Total Hours per Person	Average Chargeout Rate	Total Time Capacity
Owners	3	2,400	151	1,087,200
Technical employees	14	2,250	76	2,394,000
Administrative employees	3.5	2,100	48	352,800
Total personnel	20.5			3,834,000

Total time capacity is \$3,834,000, valuing all hours (both chargeable and non-chargeable) at standard.

There are three components that reduce total time capacity to standard fees: (1) unavailable time; (2) Time not recorded or not delivered to the firm; and (3) sales variances, or planned write-downs.

Unavailable Time

Certain hours are unavailable to earn revenues: sick leave, vacations, holidays, education, firm meetings, and so on. Theoretically, if there were work available, all remaining hours would be chargeable or unassigned. In this theoretical perfectly efficient practice, any non-chargeable time would be caused by lack of proper marketing.

How efficient are you? Exhibit 2-13 shows an average firm's hours.

Exhibit 2-13: Typical Firm Efficiency

	Typical Employee	Typical Owner
ACTUAL TOTAL HOURS [1]	2,250	2,400
UNAVAILABLE HOURS:		
Vacation	80	120
Holidays	56	56
Continuing education	40	60
Sick leave	40	12
Personal time allowances	—	—
Time recording	—	—
Invoicing	—	48
Firm scheduling meetings	48	48
Quarterly employee meetings	8	8
Retreats and owner meetings	8	60
Marketing	—	100
Management and administration	—	200
Employee evaluation/development	8	60
Professional society	24	24
Other	—	—
TOTAL UNAVAILABLE HOURS [2]	352	808
[1] – [2] = POTENTIAL CHARGEABLE HOURS [3]	1,898	1,592
ACTUAL CHARGEABLE HOURS [4]	1,582	1,266
[4] ÷ [3] = FIRM EFFICIENCY	82%	80%

You can use exhibit 2-14 to do a similar analysis for your firm.

Exhibit 2-14: How Efficient Is Your Firm?

	Typical Employee	Typical Owner
ACTUAL TOTAL HOURS [1]		
UNAVAILABLE HOURS:		
Vacation		
Holidays		
Continuing education		
Pro-bono work		
Sick leave		
Personal time allowances		
Time sheets		
Invoicing		
Firm scheduling meetings		
Quarterly employee meetings		
Retreats and owner meetings		
Marketing		
Management and administration		
Employee evaluation/development		
Professional society		
Other		
TOTAL UNAVAILABLE HOURS [2]		
[1] – [2] = POTENTIAL CHARGEABLE HOURS [3]		
ACTUAL CHARGEABLE HOURS [4]		
[4] ÷ [3] = FIRM EFFICIENCY		

Time Not Recorded or Not Delivered to the Firm

As we saw in exhibit 2-13, potential chargeable hours could be 1,898 for typical staff and 1,592 for typical owners. Yet CPA firms don't record that many chargeable hours.

Why not? I have identified two potential problem areas:

1. My personal interviews and reviews of actual time reports show that some CPAs, both employees and owners, charge at least one hour a day to various nonchargeable activities, even when they are occupied all day long on chargeable engagements.
2. You may have noticed that certain employees and owners have lower chargeable time than normal. My investigations show that professionals in the same firm have considerable differences of opinion as to when time is chargeable and nonchargeable. A large percentage of your employees, and even some of your owners, do not understand the

nature and importance of accurate charging procedures. Further, some of your fellow owners might have different philosophies on when to charge time and how much time to charge.

Less experienced employees lean in the direction of under-charging. And owners whose chargeout rates have been set by the firm higher than they think they are “worth” tend to under-report their time. Their approach could best be described as, “When in doubt, show the time in one of the nonchargeable categories on my time sheet” or do not show it at all.

I have observed the following particular problem areas:

- Telephone calls, texts, or emails: Some people feel guilty charging one-quarter or one-tenth of an hour for having a four-minute telephone call or responding to a text or an email. Others somehow feel that electronic communication is not valuable to clients or not as valuable as a face-to-face consultation. Therefore, these professionals do not charge for electronic communication or do not charge all the time required.
- Business-related lunch with a client: Some people have problems differentiating between the social and business aspects of lunch with a client. They have difficulty handling whether to charge for the time depending on whether the client paid for lunch. Similarly, they have difficulty determining whether to charge the client for the expense of the lunch if the accountant pays for the lunch.
- Business-related dinners or other after-hours activities with clients: The same considerations as business lunches exist, plus the complication of whether spouses accompany the accountant and client.
- Time spent researching a client problem: Some accountants view their normal performance as superhero. They rationalize not recording all their time because they think, “I should have done better,” or, “I should have known the answer to that.” As a result, they under-report their actual time.
- Evaluating their own productivity: Again, some accountants, particularly less-experienced ones, evaluate their own performance and often find it wanting. They work three hours on an assignment and charge two.
- Correcting mistakes: Many people do not grasp that mistakes are a normal part of any business activity. A person’s experience level and capabilities (and thus, their propensity to make mistakes) are already reflected in their compensation and chargeout rate.
- Taking client work home: Some firms discourage such actions. Nevertheless, it happens and your policies should make sure that the time is accounted for.
- Interruptions at work: Accountants in the tax department are frequently interrupted with questions by employees. Executives, too, are often interrupted by employees with routine questions regarding clients for whom the executive is responsible and on whom the employee is working. Often, the higher-level people choose not to keep track of these interruptions. As a result, they accumulate lots of time which

was in fact spent on behalf of clients but is shown as nonchargeable. Cure: before responding to any question, your people should ask, "Which client should I charge for the answer?" Also, you might allow tax people and executives to use tenths of an hour on their time reporting to encourage them to report such time.

- Travel time: Particular problems are travel from one client to another, travel outside normal office hours, and travel outside your normal market area.

Key Point: Left to their own discretion, personnel at all levels make pricing decisions by the way they record their time.

An increase in overall utilization from 1,200 hours to 1,400 hours is about a 16-percent increase. That may not sound like much, but that increase can be attained with little or no increase in costs in most cases. Many times, 85 percent to 90 percent of the increase can come down to bottom line.

If you are a \$2,000,000 firm with three owners earning total income of \$900,000 per year, an increase in utilization of 16 percent, even if your write-downs increased, could mean \$300,000 a year in extra income—every year. If you are a \$4,000,000 firm with eight owners earning \$1,600,000 per year, an increase in utilization of 16 percent, even if your write-downs increase, could mean \$500,000 to \$600,000 a year in extra income—every year.

Sales Variances, or Planned Write-Downs

A planned write-down is a write-down that the CPA firm anticipated before they accepted the engagement. They agreed to the price reduction for marketing or other reasons. For example, the CPA undertakes an engagement anticipated to cost \$14,000 at standard rates for a fixed price of \$10,000. The planned write-down is \$4,000. If the CPA performs the engagement for \$15,000, \$4,000 of the total \$5,000 write-down is planned. The PIC would only be held responsible for \$1,000 as an unplanned write-down. If the CPA completes the engagement for \$12,500, the planned write-down is still \$4,000, and the PIC would be recognized for a \$1,500 write-up.

An unplanned write-down occurs when engagement productivity does not meet expectation.

Chapter 3

The Pricing Myths

Unconsciously, most CPAs accept certain myths as if those myths were among the 10 Commandments. How many of the following myths do you accept without thinking?

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

- If CPAs give clients a discount, the clients will be so happy they will recommend the firm to friends or do other nice things for the CPAs.
- If a CPA or anyone else in the firm makes a mistake, the chargeable time invested should be written off.
- What CPAs do cannot be very valuable because the work is so easy for them.

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

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

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

Let's look at these myths again as I examine the reality behind each myth.

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

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

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

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

Reality: There is always time to discuss prices.

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

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

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

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

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

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

Key Point: Most clients give their CPA's invoice about as much attention as they give their electric bill.

After 12 years of practicing accounting followed by 30 years as a consultant to the profession, I have concluded that CPAs are more price conscious than their clients! And the clients who are most price sensitive are frequently your least desirable clients—the ones you would be better off without.

Myth: CPAs should raise prices only when demand exceeds supply.

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

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

- No time to plan and manage
- No opportunity to market
- No opportunity to respond to client or firm emergencies
- No personal life

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

Practical Tips: Increase prices—that is, the amount you charge for the value you deliver—as that value increases.

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

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

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

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

Ask yourself: “How can clients pay for my quality if I do not charge them for it?” Clients seldom give their CPAs a gratuity. They can pay only the amount of your invoice. Therefore, the only way for clients to pay for your quality is when you invoice them for it.

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

Reality: This concept of deliverables is important only to the extent that the tangible report is evidence to the client of the intangible service and emotional security you provide.

By themselves, reports, tax returns, letters, and so forth, have very little value. But, by demonstrating, “We put the ‘service’ in ‘financial services,’” (or the equivalent message for whatever service you render), they can be very valuable indeed.

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

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

I have asked entire rooms full of accountants, “When you send a client an invoice, how often do they know whether you took a write-down or write-up?” Over 80 percent of my audiences tell me that their clients almost never know whether the accountant takes a write-down. This is because accountants do not show write-downs on the invoice or do not otherwise inform the client there was a write-down.

Because most of the work you do for smaller clients is done in your own offices, most of the work you do for clients is invisible. British consultant Mark Lloydbottom, FCA calls it the *iceberg of time* because most of your time is “below the waterline” where clients cannot see it. Ninety percent of an iceberg’s mass is not visible, but that mass supports the visible 10 percent. Similarly, most of the time we CPAs spend is invisible to the client. Clients know we work on their behalf, but they have no idea how much time that takes.

We will discuss this “iceberg” effect in chapter 4, “How to be Worth More to Clients.”



Key Point: If CPAs do not value their time or work, neither will their clients.

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

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

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

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

Because every year is different, it makes sense that the price will be different. You must explain in your invoice the factors that were different. Chapter 12 covers ways to explain the differences in your invoice.

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

Reality: Any relationship between the amount of WIP and the true value of the job may be only coincidental.

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

Myth: Paying your invoice is as high a priority for clients as getting paid is for CPAs.

Reality: Some clients don't pay simply because the CPA has not asked them to do so.

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

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

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

In fact, not only do your clients not know what your colleagues charge, most accountants also do not know what other CPAs charge. And even if you do know what your colleagues charge, how does their quality compare with yours?

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

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

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

Myth: Asking clients to pay is unprofessional.

Reality: Not asking clients to pay is unprofessional.

If you want clients to respect you as their trusted business adviser, then lead by example. Run your own business in a businesslike manner. Invoice promptly and hold clients accountable to your payment terms. This sends the right message about you and your firm as business advisers.

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

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

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

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

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

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

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


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

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

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

Reality: The world is full of clients.

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

 **Key Point:** The Rule of SW3: “Some will. Some won’t. So what?”

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

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

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

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

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

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

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

When someone makes a mistake, that does not make the time nonchargeable. That time is still a cost of serving that client. The CPA should note in the time-keeping software that a mistake was made, but charge the time anyway. Perhaps at another point on the engagement, the CPA (or someone else) will be super-efficient and finish in less time than you thought. You may be able to invoice all your costs. If not, the write-down will reflect how well you managed your costs—the productivity variance I discussed earlier.

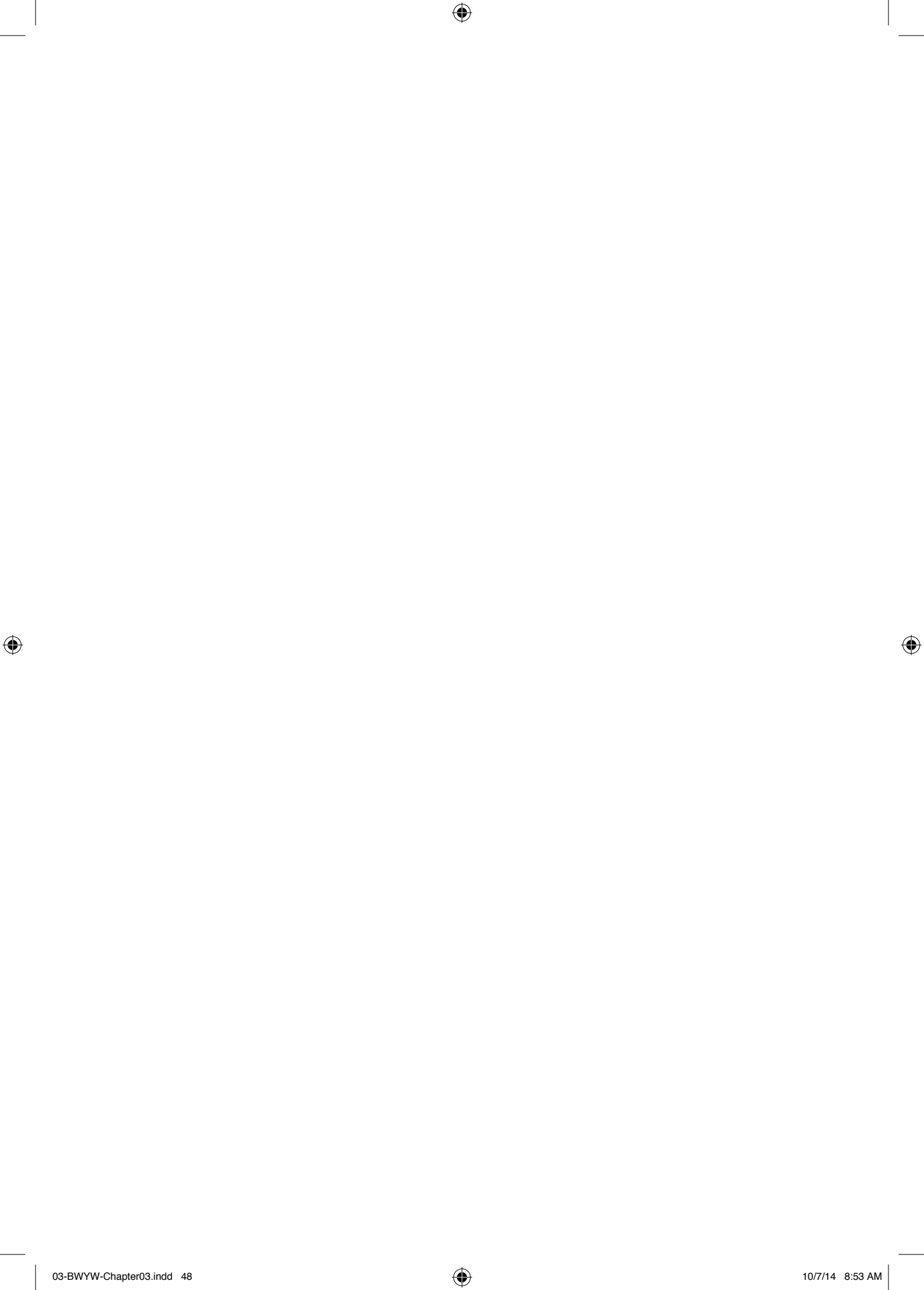
Myth: What CPAs do cannot be very valuable because the work is easy for them.

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

“It’s amazing how few people know their strengths. What comes easy one tends to disparage. If it comes easy, value it. One thinks that what comes hard is more valuable because you have to work at it.”—Peter Drucker in *Inc. Magazine*, March 1998, p. 67.

A skilled surgeon once asked the following rhetorical question: “Do you know how long it takes a good surgeon to remove an appendix from first incision to closure? Seven minutes. If you gave me two hours with anyone smart enough to finish college in four years, I could teach them how to remove an appendix. It’s simple.

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




Chapter 4

How to Be Worth More to Clients

What Do Your Clients Really Need?

Just for one moment, assume there was no regulatory requirement for audited financial statements. Assume income tax filing was so easy that everyone filed online. Consider the effect if there were no compliance work. One certain outcome is that you would focus 100 percent on meeting the needs and wants of clients. There would be no compelling reason to hire a CPA, so your services would be based on want and value as determined by the client and not on needs required by regulation.

 **Key Point:** All value is subjective. Goods and services have no inherent value. As my mother used to say, “A thing is only worth what people are willing to pay for it.”

Does this agree with your understanding of how clients view you? Well, it depends on which clients we’re talking about.

I divide clients¹ into five broad categories: A, B, C, D, and, of course, X.

¹ Treat associated clients as one client if the same people control them and you would lose them all if you lost one client in the group.

A Clients

A clients are your major clients and clients who could be major referral sources. If you sorted your clients from largest fees down to the smallest, the *A*'s typically account for 50 percent of your revenues. Any client economically significant to your practice (that is, if you lost them, it would hurt) is automatically an "A."

Most firms have from 5 to 15 *A clients* per PIC.



Key Point: Every client or referral source that is an advocate for your firm should be considered an *A client* or referral source.

A clients are profitable businesses and individuals that do, or could, benefit from a broad range of services. They pay good prices, and they pay on time. They also generate referrals—or they would if you asked them.

Caution: Larger clients who are unprofitable, slow paying, or difficult to deal with are not *A clients*. Evaluate them to determine if you can upgrade them or discontinue the relationship. Nonprofit organizations and governmental entities can fall into this category.

B Clients

B clients are your "bread and butter clients." If you sorted clients from largest fees to smallest, the *B*'s typically account for the next 30 percent of your revenues. They are good clients, just not as economically significant as the *A*'s. Often they have the potential to grow into *A*'s. Most accounting firms have from 5 to 15 or more *B clients* per PIC.

C Clients

C clients are smaller clients with potential to become *A*'s or *B*'s in the foreseeable future—perhaps in three to five years. Most firms have more than 20 *C*'s per PIC.

D Clients

D clients are perpetually small businesses who will always be small clients. These clients may not cause trouble, but they are unlikely to ever pay higher value fees, make valuable referrals, or otherwise make it onto your A-list. *D clients* may be marginal, are often not profitable to serve, take lots of PIC time, may be slow to pay, sometimes complain about fees, and are unaware of the value of your services.

X Clients


X clients (and most of you have some) are the ones you would be better off without. If you were to make a list of characteristics of your ideal *A client* and turn that list upside-down, it would describe the typical *X client*: are unprofitable to serve, give no or bad referrals, technically incompetent as an entrepreneur, ties up lots of PIC time which they don't want to pay

for, and so on. They may drag you down by consuming scarce professional resources and preventing you from working on other clients whom you enjoy more. When they do refer, their referrals are often similar undesirable clients.

How and With Whom Do You Spend Your Time?

It is likely that 80 percent of your clients provide 150 percent of your profits. This statement appears oxymoronic, but it means that a small minority of clients (20 percent or less) can hold the firm back and the firm might earn more profit without them.

An owner-accountant typically spends 2,200 to 2,400 hours working. Of these, it is usual for between 1,000 and 1,500 hours to be chargeable. Interestingly, time recording systems do not routinely permit an analysis of the time you spend face-to-face with clients (visible time) as opposed to other time, which Mark Lloydbottom calls *desktop time*, or invisible time.

 **Key Point:** To increase your value to clients, focus on the time you spend with clients. This is your one-on-one, face-to-face meeting time.

What percentage of your 1,000 to 1,500 partner chargeable hours do you spend face-to-face with clients? Many CPAs would estimate only 20 percent to 30 percent. In other words, 70 percent to 80 percent of their chargeable time is invisible or desktop time, even though some of that time is in internal meetings regarding the client.

The Potential of Client Meetings—Going from *Effect* to *Cause*

Client meetings give you the opportunity to advise. Many meetings are initiated by the client rather than by the CPA. Most of the remaining meetings arise from a need to complete a compliance engagement. In other words, the clients or the tax authorities take action and the CPA only reacts. The CPA is at the effect end of the cause-and-effect equation.

As a rule of thumb, you can increase the number of meetings you hold by 15 percent to 20 percent a year. Your final target? Many owners report that they have increased their visible time to 40 percent to 45 percent.

On average how much time do you spend with a typical client in the course of a year? My colleague Mark Lloydbottom has asked this question of over 2,000 accountants in the United Kingdom, and the results are remarkably consistent. The time accountants spend with clients in the UK over a 12-month period varies from 2 to 3 hours per client, with an average of 150 minutes. In the U.S., that might be more or less. To answer the question for you, consider what your typical client looks like. You may judge your clients by the amount

of fees they pay, the size of their revenues, the number of employees, or the client's industry sector. For the sake of illustration, let's assume 150 minutes is at least in the ballpark.

Typical CPAs spend their visible time in the following ways:

- Introductory welcome and social exchanges: The traditional ice breaker even when meeting clients you have known for years. It's the time to catch up, find out about their vacation, a sports update, or to exchange opinions about some news item.
- The heart of the meeting: The reason for the meeting. This may relate to the tax returns or finalization of the financial statements and may involve clearing queries, obtaining information, explaining reports, or reviewing them.
- Farewells and wrap up: When the meeting achieves its purpose and runs its course, this is when both parties remind each other of what they agreed to and what actions they will take.

For the typical accountant, most of these meetings concern compliance matters, as they should.

Mark's survey results indicate that, of the 150 minutes, fewer than 20 minutes deal with anything that relates to the client's present or future plans. Substitute your own numbers if they vary greatly from his research.

The Iceberg Value Principle

The mass of an iceberg has a major role to play to support the visible tip of the iceberg. But unlike the iceberg whose mass beneath the surface remains constant, the iceberg value principal demonstrates the value of increasing the visible portion, also known as your client time.

Key Point: The iceberg value principle: 80 percent of the actual value clients receive from your firm comes from the time you spend with them face-to-face, eyeball-to-eyeball.

You are your clients' number one adviser with your own expert knowledge and, like the racecar driver whose first objective is to start at the front of the pack, you hold the pole position. However, pole position does not guarantee that the driver will win the race, and your pre-eminent position with clients does not guarantee you will be your client's chief adviser. Sadly, the client may not receive advice from anyone. As the old adage reminds us, failing to plan is planning to fail, with all the consequences of that failure.


I am not referring here to only your *A clients*. *A clients* expect to spend time with you and tend to seek out your advice because they value your wisdom. Instead, I refer to the 60 percent or more of your clients who happily pay for the compliance services but do not spend more than the 150 minutes with you annually that I suggested previously, and who do not engage in structured forward planning.

The iceberg value principle says that the visible time you invest with your client delivers as much as 80 percent of the value they perceive they receive from you and your firm.

If you hold two meetings a year and deduct the time for social interaction and the discussions related to compliance work, then you have little time left for the future planning advice that client find so valuable.

How interesting that you achieve that “most trusted adviser” status in such a small time span. Imagine what you could accomplish with a focused effort!

Survey those same business clients and ask them their opinion of their CPA firm and they generally give you their opinion about their PIC—usually an owner. The reason? Clients relate to and value the time they spend with the PIC. As the relationship builds, the client’s trust and confidence in the PIC and firm grows. The invisible desktop work and time conferring with other firm employees have some value. But clients view the relationship with the PIC as key. If that breaks down, the client will leave. Clients largely form that good opinion from personal interactions they have during one-on-one, face-to-face meetings, reinforced secondarily by exchanges via email, phone, and letter.

 **Key Point:** Restating my point—80 percent of what clients value takes place in the personal interactions between the client and the PIC. These are the magic moments spent working with clients instead of on them.

If you could double the time you spend with a client, could you also double the client’s perceived value from 80 percent to 160 percent?

Meetings with clients provide opportunity for you to showcase your range of services and solutions. Meetings are also when you work with the client in a hands-on, value-driven environment.


What’s Missing? The Future!

Of the 150 minutes the typical PIC spends with the typical client each year, how much time does he or she spend discussing non-mandatory matters with clients?

I recommend you do not discuss business and financial advisory matters at the regular compliance meetings. Surprised? The compliance meetings are rather intense, focused meetings directed at tightly-targeted goals and subject to the disciplines of being able to invoice the chargeable time invested.

On the other hand, business and financial advisory meetings are more speculative “what if” meetings with a wide-ranging and flexible agenda.

To have the most significant impact on a client’s future, always schedule a separate meeting for advisory services; I will explain why later.

 **Key Point:** Giving advice about planning needs at a compliance meeting denies both you and the client the most appropriate setting for this important advice.

The Rearview Mirror Perspective

When you drive a car, the rearview mirror provides an image of what is behind you. The image covers an area about three inches by eight inches. By contrast, the area you see out of your front windshield is almost unrestricted. Is the information from the rearview important? Yes, of course, but you don't spend anywhere near as long looking behind as you do looking forward.

Similarly, the CPA's role in compliance services is to present information from the rearview mirror of clients' lives. The numbers in a tax return or financial statement show what the client has already done. This is not as important as what the client looks at out front—the future.

Our View as Accountants

We spend 90 percent of our time looking in the rearview mirror and 10 percent looking through the windshield.

Take a typical firm's financial statements and instead of analyzing the revenue between various types of service, analyze the firm's revenue between chargeable time spent working on clients' historical matters as compared to working with clients on their present and future. What would the results show? Or, alternatively, take a look at your time records and analyze time spent on historical work and time spent on present and future work. You may find that the weighting is heavily tilted towards the historical perspective.

Example: One of my small clients had 10,482.5 chargeable hours in a year, of which 9,220.5 (80 percent) were spent performing compliance services. Of the 1,262 hours spent on present and future issues, 616 hours (49 percent) were for payroll processing for clients. Only 154 hours were spent on true business consulting and 213 hours on tax planning. That is just 367 hours, or 3.5 percent of the total.

Example: The 2012 AICPA Private Companies Practice Section and Texas Society of CPAs Management of an Accounting Practice survey showed that all 2,362 responding firms' average revenues came from 74.9 percent compliance services, 8.6 percent specialist and niche services, 0.7 percent advisory services, 14.0 percent write-up and data processing, and 1.8 percent "other."

That does not represent the CPA-owner's time analysis, but many have admitted that for a variety of reasons, their client service in these areas is not outstanding, and 90 percent is probably a fair proportion of their time on compliance matters.

And so, of the 150 minutes average you spend with clients face-to-face, perhaps you devote as little as 20 minutes to future planning.

Contrast this with the results of those surveys that suggest the typical business owner regards their accountants as their number one adviser!

Look Out the Windshield

How do business owners spend their time? They buy, sell, produce, market, manage, and make decisions. Business owners focus on the present and the future. Yesterday is history. The hotel owner cannot sell rooms that were vacant the previous night, but the owner can sell rooms today. The business owner looks at yesterday when he or she signs checks, chases payments, deals with service problems, and when the accountant calls.

Business owners spend 90 percent of their time looking through the windshield and 10 percent looking through the rearview mirror.

However you view the iceberg value principle, we know that you deliver greater value in one-on-one interactions than when you work behind closed doors.

Iceberg Value Strategy

Assumption: Let's take the example where you spend 3 hours with a client over a 12-month period and let's assume that the value of these meetings, as perceived by the client, comprises 80 percent of the total service delivered. If you increased this time from three to six hours, would the value increase by another 80 percent? It would have great value when you consider that you might spend the extra three hours on profitability enhancement, management problem-solving, client-centric, or other future-focused services.

Key Point: The iceberg value strategy says that adding only three visible hours of advisory services to the client's service mix almost doubles the value to the typical client.

If the total hours worked on the client's account exceeds 30, the additional time represents an increase in time of 10 percent or less. That seems a win-win situation for the following reasons:

- The CPA spends 10 percent more time with the client.
- The client gains greater value from the firm.
- The CPA's client interaction could also lead to additional work for other team members to do.
- All of the additional work can be non-busy-season work.

Before becoming a consultant, I practiced public accounting for 15 years, 12 of those years as an owner. I know not every client wants to spend more time with you, and I know that some clients do not want their accounting costs to increase, whatever the value proposition. But, that does not apply to all clients. In fact, you may be surprised at how many clients, if you approach them in the right way with the right proposition, will say, "Yes, when can you start?"

Before we go any further I would like to address an issue I often hear.

"But My Clients Won't Pay for the Extra Service"—The Rule of Price Flexibility

Obviously, different CPA firms charge different prices, even in the same market. So we all know that if a client approached another firm, the client could probably pay less—or more.

Using the travel websites as an example, there are always those people who choose a cheaper hotel or the cheapest flight. However, the lowest cost hotel might be many miles from where they wish to be. What is the true cost of a suburban hotel that is 25 percent less than the downtown hotel? A suburban hotel could result in additional travel costs and the time necessary to conduct business. In the case of the flight options, does it make sense to save money and commit to a flight that takes twice as long after taking into account the stopovers? Looking at the cost of an economy seat and recalling the cramped feeling last time you flew economy on that long-haul journey, maybe this time you upgrade to premium or even business class.

You see, the point is that people will pay more if they receive more.



Key Point: Your better clients will pay higher prices if you deliver higher value.

There is a limit to what clients will pay. But what is that limit? How much will they pay before they feel you have asked for too much for the additional service? What is their appetite for financial advice before they reach the point where they feel it's time to find an alternative service provider whose overall costs are more in accordance with their expectations?

The strategy I suggest does not risk losing work or clients. Far from it. This strategy, which Mark Lloydbottom and I call the "rule of price flexibility," should win you more engagements, enhance the esteem in which the clients hold your firm, and increase the value clients receive. This strategy leads to clients increasing the number of referrals you receive.




Key Point: Rule of price flexibility: Clients will pay 50 percent to 100 percent more than the fees they pay for compliance services so long as current service is outstanding and they can see the value and benefit of the additional service.

Creating a High-Impact Relationship

Professional services are unique, and every client meeting is a unique opportunity. You have no idea when or where the gallon of milk at the grocery store came from, and you probably arrived at McDonald's 10 minutes after the burger was cooked. But in client meetings, the client is an integral part of the "production" and outcome of that meeting. The client experiences your meetings as an equal participant.

Your role as accountant gives you the automatic right to see your client regularly. These meetings give you a platform to present your knowledge and expertise. They also provide you an economic return at a relatively high rate for your personal time and the advice you offer.

It's difficult to build a reputation by being great at reducing tax liabilities in isolation to other areas where clients need advice.

 **Key Point:** High-impact relationships emanate from the quality time you spend with clients. High-impact relationships build trust and confidence in you and your advice.

I do not suggest that these are specialist or niche meetings or that you should begin to view yourself as a consultant instead of an accountant, although this may indeed result.² These are “one small step” meetings that you can view as an extension of your current interactions with clients.

The goal of a typical meeting? Work with clients, agree with them about what they can and should do next in their business and personal financial life, and then see the advice through to its implementation. To make your advice credible with clients, actions must follow words. You do that by performing the following steps:

1. Taking your share of responsibility for any failure to implement.
2. Ensuring that you receive nagging rights to keep in contact with the client and see the agreed decisions through to implementation. Sometimes you may propose actions that are correct but not immediately possible; or your recommendations are in an area that is not yet at the top of the client's agenda. You must have nagging rights to keep bringing the subject up until the client implements the recommendation, usually with your help.
3. Absent nagging rights, get the client to engage you to implement the decision he or she has made. This also generates additional revenues for you.

And so the first small step is to focus on the core areas where your clients need discussion, decision, and implementation.

The Meeting Plan Campaign

How do you start?

First, remember that if one, two, or even three clients say, “Thanks, but no thanks,” to another meeting, that does not mean that all clients will say no. Those who decline have other matters on their mind and are not convinced about the advantage in a further meeting. This will happen occasionally, so if it does, do not be deterred—your clients need you!

² Some clients feel intimidated by the word “consultant.” They feel more comfortable with an “adviser.” To some clients, consultants make the decisions instead of their clients. Whereas, advisers give advice and the client has the right to make the decision.

Lessons from a Mime—Transition Your Client From Compliance to Advisory Services

The mime uses a number of techniques to signal to the audience that he or she is changing their portrayal. The announcement is silent—perhaps a 360-degree turn or bringing the hand down in front of the face and so on. The mime makes it clear that a change in the scene is about to occur.

When you meet with clients for a compliance meeting, don't offer advice that is outside the scope of the meeting—for example, advising about other planning issues. The client is not expecting such advice, nor prepared for any serious discussion about other present and future issues. Your client may need to do some research, perhaps bring someone else along to the meeting—such as a spouse or partner. Don't catch your client by surprise or make an unexpected foray into estate planning or other non-compliance areas. Use this compliance meeting to agree to reasons for the next (planning) meeting.

Eliminating the element of surprise is important for a number of reasons:

- It avoids taking the client by surprise when you seek to transition the client into another service.
- You need to embrace a process that allows the client to participate in discovering what planning he or she needs to do next.
- You need to give the client time to think in advance.
- The confused mind always says, “No.” Don't confuse the client.
- You need a process that delivers a, “Yes, when can we start?”

Meetings have different phases, and clients need to know when you transition from one phase to another.

How Not to Do It

Most encounters with a client over a 12-month period do not extend much beyond compliance matters. Let's assume that you wish to use the next client meeting to discuss an area that could create an opportunity to offer your new service. You decide to use a new approach to introduce this service to your client. The key here is that you have a new initiative. It might be financial planning, estate planning, profit improvement, strategic planning, or something else. Your agenda is to get the client to agree to the service. Your client likes you, trusts you, and values the time he or she spends with you.

So the moment arrives when you intend to introduce your new approach, your new service. Like an automatic gearbox, your transition is smooth, in fact almost unnoticed. To the client, you continue with the accustomed compliance meeting in the client's office or your office.

But then the client realizes there is more to this meeting than expected. The discussion is a precursor to another engagement, and you explain to the client the benefits of this work. Even when the client has been pleased with what your firm has done and the advice you have given, your client may feel sandbagged. The client may feel that you called the meeting under false pretenses, and he or she may think you are charging for the time you take to sell a new service!

That is why I said earlier, “To have the most significant impact on a client’s future, always schedule a separate meeting for advisory services.”

A Better Approach

If you must combine the two types of meetings, make it clear to the client that the compliance element of the meeting has ended and that the meeting is moving into a new phase. This enables the client to open his or her mind to a new area of discussion.

You get the best results when you separate compliance meetings from advisory services. Thus compliance meetings (such as tax, audit, and accounts discussions) should be the subject of one or more meetings, and advisory meetings of any description should be separate.

Inform the client in advance of the scope of the meeting and give some information the client can study in advance. Clients know their business well; it is a major responsibility in their lives. When they visit you, they should be familiar with the scope those discussions will encompass. A sample meeting agenda is provided in exhibit 4-1.

Exhibit 4-1: Sample Meeting Agenda

In attendance:

Year under review—compliance matters

1. Review financial statements and clear outstanding queries.
2. Review expenditures to confirm that all expenses can be deducted and tax elections have been considered.
3. Review your benchmark analysis and industry trends.
4. Review your tax computations, tax saving options, and the due dates for payment.
5. Your feedback on our services this year. How well have we met your expectations?
6. Where could we improve?
7. What other points would you like to discuss relating to last year’s accounts?

Practice Tip—Questions are like seeds, plant them and they will help your conversation grow.

Your current year—current matters

8. How is the business currently performing?
9. What challenges do you see in the future?
10. How do the results-to-date compare to the profit plan? [Does the client have a profit plan? Does the client need up-to-date management reports?]

11. How do you see the business developing?
12. What do your competitors do that is of interest or causing you concern?
13. What other points you would like to discuss relating to this year's operations?

Practice Tip—Try asking some of these off-agenda questions: What keeps you awake at night? What is going on in your business that cannot be ignored? What happens in your business that needs to stop? Alternatively, what is on your stop-doing or not-to-do list? 4) What can you be the best in the world at? 5) What is it okay for you not to be the best in the world at?

Personal matters—the planning keys to life after work

14. With the recent changes in estate taxation, there may now be a much greater liability to estate taxes. Would you be interested in strategies to reduce your estate taxes?

Practice Tip—Or, if the client has children and has no will, “Do you know what will happen to the children if you both die? Who will look after them?”

15. We all hear about the “Social Security crisis” and the importance of saving for the future. Our firm believes that a good business owner should be financially independent of the business by the time the owner is 55. Have you considered what level of income you will need in retirement when the children have left, the mortgage is paid, and you have more time to pursue your other interests?
16. Review our services and charges—making sure you, the client, are in tune with our value given.
17. Discuss and confirm our work this year and confirm arrangements for invoicing and payment.
18. Discuss the services you wish us to provide in the forthcoming year.

Other meeting questions:

19. What additional services would you like to see us offer?
20. How can we help you with your business planning?
21. What else could we do to make your client experience better?
22. Are you happy with your banker and lawyer?

and finally...

23. Anything not covered previously? (Have we identified your concerns, problems, worries, hurdles, and how you see the future?)

Practice Tip—A word of caution: Be careful in building in your *spur questions*.³ Intersperse them here and there; make your conversation seamless. Make your questions advisory as previously mentioned or, “We’ve helped other clients with their business planning. Would you like to talk to someone at our firm about this?”

³ **spur question:** a question which calls a person’s attention to a dissatisfaction with some area of his or her life and motivates that person to want to improve that area.

At this stage you could also thank the client for the opportunity to serve him or her and ask if the client knows anyone else whom you should meet.

Practice Tip—Don't ask, "Who do you know who needs a great accountant?" because most of the time the client will say, "No one, but you will be the first person I mention if anyone asks me." Instead, ask, "Who do you know that would make a good client for us?"

Surveys confirm that over 95 percent of clients would happily recommend, but that virtually all those who are happy to recommend cannot recall ever being asked to make a recommendation. This is where you need to be proactive rather than inactive. When clients do recommend you, be sure to acknowledge and thank them for their confidence in you.

Remember that relationships require visible time so you can ask questions, listen, and identify areas of client concerns. You cannot build a meaningful relationship by asking only the questions that relate to information you need to complete a compliance engagement.

Practice Tip—Ask the right questions, listen well, and resist giving premature solutions—then you will have your clients eating out of your hand.

At the end of every meeting, ask the client four questions:

1. Did you accomplish your objectives for this meeting?
2. Is there anything else I should know?
3. Is there anything else I can do for you?
4. When should we schedule our next meeting?

The first question asks the client for an indication of satisfaction, the second invites the client's cooperation and communication, and the third clears up any mysteries (such as "What does that mean?") or any unexpressed expectations or needs. The final question puts you into a "virtuous circle" of continuous client meetings.

A Realistic Meeting Schedule

Visit your *A clients* at their place of business every 90 days, even when you have no current assignment from them (assuming they are within commuting distance).

See your *B clients* at their place of business every 180 days, even if you are not currently working on an engagement (again assuming they are near your office).

Visit your *C clients* at their place of business every year or so, assuming they are reasonably close to your office.

Most professionals are so busy they cannot even contact their *A clients* and *B clients* regularly. The CPA often ignores the *C clients* when they ask for something.

Delegate your *D clients* to a manager, supervisor, or in-charge to handle the relationship.

X clients (and most of you have some) are the ones you would be better off without. Terminate the relationship in a friendly fashion.

Exhibit 4-2 summarizes client contact schedules for your various client types.

Exhibit 4-2: Client Contact Schedule

Class	Description	Definition	Action Schedule
A	Major	50 percent of revenues	Meet every 90 days
B	Bread and butter	30 percent of revenues	Meet every 180 days
C	Small with potential		Meet annually to discuss the tax return or review financial statements
D	Perpetual small clients		Delegate to employee or hand over to a competitor
X	Clients you would be better off without		Terminate relationship

Caution: Do not “bill them out the door” with a large invoice. Instead, write or telephone *X clients* and explain that your firm cannot continue to serve them for the prices they have been paying. Explain that you would have to double or triple their fees to continue serving them and that you would be glad to allow another professional of their choice access to your files for a smooth transition.

Chapter 5

Client-Care Key Performance Indicators

A *key performance indicator* (KPI) is a selected measure that evaluates the success of a particular activity of a business in a specific area. KPIs enable business decision-makers to take actions to achieve desired business goals.

Most CPAs agree that client satisfaction is key to the success of a CPA firm. Yet many CPAs are not aware that client satisfaction can be measured beyond the occasional client survey.

There are several ways to measure client satisfaction other than the conventional client survey. I'll cover them later, but first let's cover the most common client-care KPI, the client satisfaction survey.

Client Surveys

When I ask firms why they don't monitor their performance in client-care areas, they have several of the following common excuses:

- A client survey is a one-off event that demands too much time and resource commitment.
- A client survey won't tell us anything we don't already know.
- We are not in a good place right now and don't want to hear any more bad news.
- Let sleeping dogs lie. Our clients might have some latent dissatisfaction. Asking about their satisfaction might stir up trouble.

Some firms that survey their clients only receive 15 percent to 20 percent response rates. What do the other 80 percent to 85 percent think about the firm?

The following are a few survey responses:

- We don't care for the PIC.
- We are considering changing CPA firms.
- We have a couple of business problems that our CPA could help us with, but no one from the firm followed up after we called asking for help.
- We're not happy with our bank (or lawyer, or financial advisor, or insurance agent, and so on).
- We have a complaint we were just about to call our CPA about.

But other responses might include the following:

- The PIC we work with is very helpful.
- We have recommended you on a number of occasions.
- We are interested in your other services.
- Great work, great people.

"Feedback is the breakfast of champions." As good business owners, it is your responsibility to give clients the opportunity to express their views on your performance. Clients deserve to be heard. The issue is how to institutionalize client feedback.

Learn lessons from other service providers such as hotels, tour operators, automobile dealers, and so forth.

You can obtain client feedback several ways:

- In reception: Just before the client sits down, your receptionist could ask, "Would you please spend a minute or two to answer some questions about our firm?" If so, the receptionist hands them a brief questionnaire. The client can place the completed response in a sealed envelope for the receptionist, or drop the sheet in a "Feedback Please" box in reception.
- After an engagement is completed: Give or send a questionnaire with the report or after you complete the job. Include a postage-paid envelope.
- Your website: Email your clients a link to a secure place on your website for a client survey.

Many client surveys are too long; others are too short. Some ask the wrong questions. Some don't ask the right questions. Fortunately there are a variety of resources available on designing useful surveys.

Here are a few sample questions:

- Are there any areas where you are dissatisfied with our service?
- Can you tell us any areas where we need to do things differently in order to improve?
- We aim to bring real value to you and help you achieve your goals. To what extent have we helped you in the past year?

- We want to help you reach your business and personal objectives. Where do you want to be in a year's time?
- What would it mean to you to achieve these goals?
- What more can we do to help you?

The golden rule is that you always thank every client for completing a survey form. If the client expressed anything less than top-of-the-line grades for the firm, address that area immediately.

Other Ways to Measure Client-Care

Time to Complete the Engagement

Go the dentist or chiropractor and you will probably be out in less than an hour. Take your car in for service before work in the morning and you will likely get it back the same day.

Clients have learned to expect prompt turnaround from a variety of service providers.

What have they learned to expect from your firm?

Look at a typical engagement—for example, a corporate-complied or reviewed financial statement and tax return. The client is ready on February 1 and the job is completed March 28—elapsed time in your shop of 56 days. In that time, we work 84 hours to complete the service and work on it on 12 different days. That means that we did not work on it for 44 of those days, or 79 percent of the time.

What should those numbers be? I don't have the answer. And the answer would be different in August than in the busy season. Yet your firm could establish some sort of benchmark and make all engagement personnel aware that timeliness of turnaround is important.

Mark Lloydbottom suggests you contact clients six or eight weeks before their year-end with a checklist of items for them to complete to help you with your engagement. "You will probably start with a standard checklist but this will need personalising [*sic*]. Maybe the last task on a job is to update the list of client-required information for the subsequent year."¹ Include the date you expect to receive the records from the client. Call or text the client a reminder two weeks before that due date. When the records arrive, make sure they are complete.

When all your team members focus on timeliness, client satisfaction will improve.

Three Other KPIs

These additional client-care KPIs have two dimensions. First you can measure them by client for an indication of how happy the client is. Secondly you can measure them by PIC. This indicates how well each PIC is striving to satisfy the clients for which he or she is responsible.

¹ Deeper—Advanced Practice Management Strategies, page 63.

Number of Client Meetings

Set targets for the number of firm meetings with each client and monitor the number of meetings. Refer to the chapter 4 section, "The Meeting Plan Campaign," for goals for each type of client. From the PIC point of view, also establish targets for each owner as part of their annual goal-setting. For example, visit each *A client* every 90 days, *B client* every 180 days, and *C client* every year or so.

A typical CPA firm owner might have 15 *A clients* which would call for 60 meetings per year. That same owner could also have 20 *B clients*, accounting for 40 meetings per year.

In the busy season, say 12 weeks, most owners find it impractical to take client meetings other than engagement-specific meetings. Allow another five to six weeks for vacations, holidays, sick leave, and firm retreats, and an owner has only 34 weeks to meet with *A* and *B clients* 100 times. That's three meetings per non-busy-season work week. Perhaps that could be your firm's goals for each owner with a mature client ledger.

An owner might have 50 or more *C clients*, but that's not particularly relevant for my purposes, because I have observed that most owners cannot even contact their *A* and *B clients* regularly. As a practical matter, most owners ignore *C clients* unless the client asks for something.

Value of Additional Work Sold

Track the value of additional, non-compliance work done for clients. The happier clients are with your work, the more likely they will engage you for additional services. This is especially true for your larger clients because larger clients have more complicated operations and are a more fertile field for additional work. For example, an *A-client* target might be additional work each year of 20 percent of the value of its compliance work. On the other hand, a *B-client* target might be 10 percent.

Each owner's goal might be to sell 10 percent or 15 percent of his or her compliance ledger in additional work each year.

This requires an accounting and time-keeping system that allows you to analyze revenue by type of service. See exhibit 10-2 for sample cost-effective service codes which enable you to analyze your work by type of service.

Value of New Client Referrals

Track the value of new client referrals from existing clients. The happier your current clients are, the more likely they are to refer other clients to you. A realistic goal is to receive two quality referrals a year from each *A client* and one quality referral a year from each *B client*.

Also track new client referrals by PIC or owner. A benchmark is to bring in new clients with estimated annual fees of two times the owner's chargeout rate for the time spent marketing. For example, an owner with a \$300 chargeout rate who spends 150 hours marketing (\$45,000 at standard) should bring in \$90,000 of new revenue per year, or twice his or her chargeout rate.

This measures both the client's happiness (his or her willingness to refer friends and colleagues to your firm) but also your PIC's willingness to ask for referrals.

Chapter 6

Pricing Strategies in a Troubled Market

*“There is nothing wrong in change if it is in the right direction.
To improve is to change, so to be perfect is to have changed often.”*

—Winston Churchill

There are several types of economic stress, and each has different effects on people's behavior.

The first type is an isolated but noteworthy event that changes people's economic behavior in the short term. Examples include the following:

- The September 11, 2001 attacks when four airliners were hijacked and crashed.
- The Eurozone near-panic of the summer of 2010 when the Greek and several other Eurozone governments appeared to be near defaulting on their debts.
- The disappearance of Malaysia Airlines flight mh370.

These events may not affect the particular client sitting in your office, but they color client perceptions of the relative safety of their world and influence their behavior—at least in the short term. After September 11, many people would not travel by air for many months; others avoided large shopping centers or groups of people, fearing another terrorist attack. One of my friends even sold his investments in Real Estate Investment Trusts (REITs) that owned large shopping malls and reinvested the proceeds in REITs that owned strip shopping centers. He told me, “A terrorist attack on a large regional shopping mall anywhere in

the U.S. will cause people to avoid large malls in droves. But they will still have to shop, so I think they will shift to smaller strip shopping centers.”

A second type of economic stress is personal stress such as when a person is unemployed or that person's job is in jeopardy because the employer is not doing well economically. Such conditions may affect only a small number of clients, but they have long-term implications for those clients' behaviors even after the particular stress has ended. One friend who was a high-level executive in a major corporation almost lost his position during a corporate power-struggle. He was in his late 40s at the time and the prospect of finding a comparable position paying his salary, at his age, without having to move to another city was grim. He kept his position, but the uncertainty of this event profoundly changed his and his wife's economic behavior. He realized how precarious his financial condition would be if his six-figure salary ended unexpectedly. He and his wife ceased all nonessential spending and began saving and investing much more than they had before. He was now concerned about his economic future in a way he never had been before. They placed a huge emphasis on getting out of debt, also.

A third type of economic stress is a recession or widespread economic dislocation such as the Great Depression of the 1930s or the Great Recession which began in 2008. These events affect not only the particular client sitting across from you but also your entire client base and the market in which you operate. An entire generation of people who lived through the Great Depression had very different spending patterns and attitudes toward money than the generation born after World War II. The depression generation wanted to avoid debt. The post-war generation did not see debt as a problem. Some people believe that the Great Recession will have a similar long-term effect on those of us who are adults in the early 21st century.

A fourth type of economic stress is uncertainty about the nature of future changes in tax laws or business regulations. Investors as well as business owners often defer economic decisions in the face of perceived uncertainty about scheduled or proposed changes in taxation of estates, dividends, capital gains, the perceived likelihood of changes in control of either house of Congress, and so on.

Another type of stress is uncertainty about pervasive economic changes from a decline in financial stability resulting from the federal government's structural deficits and unsustainable entitlement programs. Americans have seen the pervasive problems in other countries in the Eurozone and elsewhere that face structural deficits similar to the one in the United States. Many fear that our current financial path is unsustainable.



Key Point: Times of uncertainty—whether real or perceived—cause people to become more economically conservative than they normally are.

In earlier chapters, I have covered several tactics that apply in both normal and troubled times. In this chapter, I will revisit those earlier items as well as cover some new observations about dealing with economic uncertainty.


In chapter 8, I will cover *What “How Much Is This Going to Cost?” Really Means* in greater detail. For right now, consider that even in the best of economic times, most people want to know how much something will cost before they commit to buying it. In times of economic stress, this tendency is both more common and much more intense.

I will cover four reasons people ask, “How much is this going to cost?”:

1. People want to know their options. While people may not have an option not to file a tax return, they can choose to delay or decline a financial planning engagement or upgrading their computer system or accounting software. They may also react to uncertainty of future tax laws such as doubts about whether the estate or death tax will be changed, whether tax rates on capital gains or dividends will be changed, and so on.
2. People want to make sure they can pay for the service. A person who is economically stressed avoids new debt and tries to reduce or pay-off old debt. This results in the delay or elimination of many discretionary expenditures.
3. People want to keep the CPA under price pressure. They signal to the CPA that they will watch the cost closely. This happens especially when business cost-cutting is “fashionable” and receiving publicity in the business press.
4. People want to appear more knowledgeable than they are. An economically-stressed client may ask about cost even though he or she has no idea how much a fair price is.

These clients are grasping at straws in the attempt to lower costs.

As I said: When you are the buyer, you try to buy at the lowest price. It is every consumer’s job to buy what he or she buys at the lowest price. Clients are just like other customers, but they are often better negotiators. In troubled times, people will negotiate even harder and also change their buying habits.

 **Key Point:** Don’t take a sudden price sensitivity personally—take it professionally. The client has not suddenly lost confidence in you; he or she is simply responding to personal economic pressures.

Retailers and consumer goods manufacturers of all stripes—from Wal-Mart to Neiman Marcus, from McDonald’s to Chili’s, from Procter & Gamble (P&G) to Frito-Lay—responded to the recession that began in 2008 by offering lower-priced options. By July 2009, Procter & Gamble had created cheaper brands to serve markets that could not afford to buy P&G’s premium items. Procter & Gamble brought a wide range of consumers to P&G products at lower price points. P&G created products like Tide Naturals that cost less to make than traditional Tide and could sell at lower prices. The stratification in the product line allowed P&G to compete for lower-income or more conservative consumers, thereby helping the company sell more units and continue to grow. In essence, P&G adopted a similar strategy to those of car companies, computer makers, and designer clothing makers; P&G created a variety of brands at a range of prices to give every potential customer a chance to buy from P&G, whether or not they could afford the top-of-the-line product.


Should you do this? No. You are not Procter & Gamble. In chapter 7, I will discuss *Four Levels of Business Service* with its bronze, silver, gold, and platinum packages and three levels of individual services with mail service, team service, and partner service. These varying levels of service offer clients a variety of ways to respond to their own perception of the amount of economic stress they are under.

Previously I related how my wife and I had each reduced the price of eyeglasses we were buying—my wife by \$200 and me by \$42.

To summarize my wife's tactics: The salesclerk asked for \$438 for the glasses; my wife asked her to reduce it. The salesclerk then asked for \$300; my wife asked her to reduce it. The salesclerk asked for \$238; my wife agreed.

While my wife never said no to a single price the salesclerk quoted, your clients may behave differently. They might say they can get it cheaper elsewhere. They could threaten to take their business elsewhere.

Let's restate the obvious.


 **Key Point:** Every consumer tries to buy what he or she buys at the lowest price. Clients are just like other consumers, but they are often better negotiators than their CPA is.

What should you do if a client asks for a lower price?

When my wife said she wanted to pay less, the clerk could have asked, "Which of the features you have chosen should I eliminate?" You could do the same—offer to cut back certain services the client has requested—perhaps from gold-level service to silver or bronze or from partner service to mail-in service.

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

I am in business just like you. To stay in business, I have to make a profit. I am willing to work with you to decide the appropriate level of service you need to achieve your goals. And¹ I have to make a profit delivering that level of service or I wouldn't be in business to serve you in the future.

 **Key Point:** The problem with most accountants is that we give discounts to people who don't even ask for them. But just because a client asks for a discount doesn't mean you have to say "yes." And you must say "no" in a tactful manner.

Previously I said to always discuss price before you perform a service. This is especially important with clients who are under economic stress. Even a long-term satisfied client will behave differently when his or her business is performing poorly. You must take advantage of the greater negotiation leverage you have with a client before you perform a service than after.

¹ Note the use of the word *and* instead of *but*. *But* means, "Disregard everything I have previously said." *And* means, "Everything I just said is true and here is a related fact...."

One important factor affecting the client's perception of your value is your own attitude toward your prices.

For example, you might explain to a client, "Charlie, I know that you are having a rough time of it. Many of my clients are. And we are making compromises wherever we can to keep our prices down. Nevertheless, I have to make a living—not only for my sake, but for the sake of my employees. We have to keep our doors open. And to do that, we must charge a fair price."

Most clients will pay a fair price. They are chiefly concerned that other clients pay comparable prices. Remember that if you offer a discount to one client without a very good reason, other clients are likely to find out and want a similar discount.

What can you do about a client who truly needs a service that he or she cannot pay for? You can be flexible with your payment terms. Charge the client your regular price, but allow him or her to defer payment of a portion of the invoice, with interest, until the client's business turns around.

Consider saying to your client, "Charlie, here's what I can do. I will charge you the right price for your level of service—currently that is \$_____ per month. But you only have to pay us 70 percent of that. The other 30 percent we will carry as a receivable and charge you ___ percent interest. You can repay us when your business turns around."²

The Problem With Price Estimates

Price estimates are just that, but we accountants often fail to communicate that to clients.

Economically stressed clients often have what I call a *convenient memory*—they remember those things that are convenient to remember and they remember in a way that is most beneficial to their interest. Such clients may "remember" that your estimate was really a fixed price even though you did not intend that. That is why I recommend you estimate a project on the high side and then give the client a pleasant surprise. Then the client will learn that the estimate is usually a worst case.

The danger, especially with new or economically stressed clients, is that a high estimate will, in fact, prompt them to shop your price. To prevent this, give the estimate as a range, explain all the variables, and explain what the client can do to help keep the price low.

How to Avoid Professional Panic

Client turnover may increase during a recession. Not just from clients going out of business, but from newly cost-sensitive clients shopping for cheaper accounting firms.

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

² You might not be able to make such an arrangement with an attest client. If you become a significant creditor, it might affect your independence.

These commodity shoppers are a small part of the market for your services. They may be 2 percent or 10 percent—no one knows. The size of this market segment changes according to economic conditions and competition, including the competition from non-accountants such as bookkeeping and income tax services.

Key Point: Assume for the sake of illustration that these shoppers make up 10 percent of the market. The shoppers may change firms every four years or 25 percent turnover. Assume 90 percent of clients change CPA firms seldom or never—say, once every 20 years or 5 percent turnover. That would mean that in a typical year, a shopper is five times more likely to approach you as a prospect than would a typical client. So, even if they are a small portion of the market for accounting firm services, these shoppers will be a large portion of all the prospects you see.

Key Point: When four out of five new prospects you talk to tell you, “I am changing accountants because my current CPA charges me too much,” you will get an inaccurate picture of the marketplace.

Many accountants are unduly influenced by the often idle complaints or comments of a small number of “in play” prospects. Yet the fact remains that the vast majority of your clients are happy with your prices. Over 90 percent of them come back year after year. Many of my clients report over 95 percent client retention each year.

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

Ask for a Deposit, but Don't Expect It

Chapter 8 will suggest that you ask for a deposit from a new client as an evidence of his or her commitment to the relationship. If clients are unwilling to pay a portion of your price before the service, they may be unwilling to pay after the service.

But in a recession, people are not as willing to pay in advance. There is that desire to hold on to cash, not go into debt, and be economically conservative.

Be flexible in your terms and make it easy to buy—especially when times are tough. In normal times, most clients who engage you don't have cash-flow problems, but in turbulent times some prospects have a problem with making a deposit. If your due diligence discloses no other problems with clients, accommodate them. As long as clients pay the agreed price for your yearly services over the year you deliver the services, I don't see a problem. Naturally, you have to make allowances for interest in such customized arrangements.

How to Handle Price Complaints

We will cover two types of price complaints: those from clients over a submitted invoice and those from prospects over a price quote for a new engagement.

Current Client Complaints

When a client complains about a price, ask him or her, “Why do you think the price is too high?” When a client complains about a price, the price is not the real problem 9 out of 10 times. The problem is some aspect of the service. But the client may not know how to articulate the real complaint and so he or she focuses on price. If you ask why, you can find out the real problem.

Here are a few reasons, other than price, that people complain:

- They didn’t get what they expected. You promised them something (or they thought you promised them, which is the same thing) and they didn’t get it. It might be as simple as a callback you didn’t make, or a copy of a document you didn’t send.
- Somebody was rude on the phone or in person. Obviously it wasn’t you (I hope), or the client wouldn’t have told you; the client would just have faded away, never to be heard from again. But it might have been one of your associates.
- The client feels that no one made an effort to serve her or him. The client feels that your firm is indifferent to his or her needs. The client may have been ignored, unacknowledged, or unappreciated.
- No one is listening to the client’s concern.
- Client-contact people project a can’t-do or other negative attitude.

People with complaints want someone to listen, sympathize, apologize, and, if indicated, correct the matter.

Listen—Really Listen

The first problem most complainers have is that nobody listens to them. We all have something to say, and we keep searching for someone to listen. This is especially true when a person has a complaint.

Key Point: The number one thing complainers want is to tell someone about it. And they will.

A complainer is carrying around a 100-pound sack of rocks, looking for someplace to unload it. If you won’t take the sack, the complainer will take rocks out of the sack and give some to everyone he or she meets. People with complaints will always tell someone about it. Obviously, you want them to tell you so that they will not feel that they need to tell their neighbor.

Here are a few simple rules to handle complaints effectively:

Rule 1—Listen sympathetically to the complaint. Listen to the whole complaint. Do not interrupt except maybe for clarification, and even getting clarification is not a good idea until the client finishes his or her narrative. Do not make excuses or try to answer the client until he or she finishes saying everything.

Caution: It's tempting to think that listening means waiting for your turn to talk. However, if you are just waiting for your turn, you lose. Hear the complainer out completely without interrupting.

There are many other rules to handling complaints, but because this book is only about pricing, I will give you only this smallest of summaries:

Rule 2—Show understanding and concern.

Rule 3—Mutually agree on a solution. Occasionally, you might even ask, "What can I do to make this right with you?" Do they want the service redone, a price reduction, an apology, or something else?

Caution: Be very careful about granting price reductions. You might inadvertently train clients that you will reduce your prices if they complain. This is a destructive game that you cannot win and that will destroy most client relationships. My general advice is to never cut a price! Some clients will try to dicker over your price no matter how much or how little it is. Once you establish the precedent of surrendering your price, you have ruined them as good clients. They will come back again and again for price concessions.

You won't look very professional.

Rule 4—Follow through. Do what you say you will do.

Rule 5—Follow up. Call clients back, and ask them how they feel about your firm now.

Rule 6—Learn from your mistakes. After handling any complaint, always ask yourself two questions:

1. What would have prevented this problem?
2. What change should I make in our operations to ensure that this doesn't happen to someone else?

By the way, nobody wins them all. Some people just like to be mad. Learn to accept defeat philosophically when you lose one.

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

Price Objections from Prospects

Sometimes a prospect makes a comment such as, "That sure seems expensive." This may not be an objection, just a statement of fact. Sometimes you can just agree with the comment or act as though you did not hear it. Think of yourself as a Mercedes-Benz salesperson. If a prospect says the car is expensive, you can just agree with that statement of fact.


Once you agree with the comment, it is no longer a controversy and the prospect finds it more difficult to make a future issue of it. Nevertheless, it does indicate a sensitivity that you will need to address later.

“Your price is too high.” At some point in almost any presentation, the consideration of prices arises. A claim by the prospect that the price is too high usually means you have not created enough benefits in the prospect’s eyes. Or it may mean the client likes your proposal, but he or she just cannot invest that much money right now in your services. To prepare for this last eventuality, always give prices as a range if possible; never quote a single figure. Bundle your answer; do not just mention the price alone.

Example: “To review the prior years’ tax returns, evaluate your current options, prepare this year’s return, and plan your year-end bonus payments, we estimate that our price will be in the range of \$3,000 to \$4,500.”

Bundling your services by summarizing all that you propose to do makes the price seem smaller by comparison to the vast array of services you propose to provide. This also gives you the leeway to re-estimate your price if that should become necessary.

As I said earlier, my general advice is to never cut a price! Some prospects try to dicker over your price no matter how much or how little it is. They want to start your prices at a low level so that it is harder to raise them in the future. It’s all part of the game of business; don’t take it personally.

 **Key Point:** Once you establish the precedent of surrendering your price, you may have ruined them as a good client.

However, you may re-estimate your price by scaling back the scope of your engagement (at least in the prospect’s eyes). Re-estimating is easy when you have bundled your services in your initial estimate. Just eliminate one or more of the list of items you were going to do, and quote a new estimate. In fact you may have taken out \$1,000 of time at regular rates and reduced the price \$1,500, but the prospect does not know it.

One firm did extensive write-up engagements. The firm’s proposals for write-up services would include the following list of services:

- Preparation of the following quarterly payroll tax returns:
 - Form 941 Employers Quarterly Federal Tax Return
 - Form XXX State Employment Security Quarterly Report
 - Form XX Employers Return of State Income Tax Report
- Completion of the following accounting services each month:
 - Reconciliation of checking account
 - Preparation of cash receipts and cash disbursements journal
 - Preparation of check register
 - Posting of transactions to general ledger
 - Preparation of detailed general ledger

- Preparation of monthly compiled financial statements including the following:
 - Balance sheet
 - Income statement for the month and for the period then ended, with comparative figures for the prior year
 - Statement of cash flow for the month for the period then ended, with comparative figures for the prior year
- Preparation of payroll checks
- Preparation of the following annual payroll tax returns, and so on

This extensive menu of services to be performed made it a much easier discussion about which services to omit if the firm was met with price resistance.

Never reduce prices just because the client thinks you are expensive. The better clients will pay for the better service provided by an excellent, client-centered firm, even during hard times. Better clients recognize that good accountants are not an expense; they are an investment. An accountant aiming for a top-of-the-line clientele should always respond with, “Well, we are expensive, and our clients think we are well worth it.” In other words, never tell clients that you are as cheap as anyone else or that your rates are competitive, if you are not.

The attitude of the excellent firm is, “We charge more, and we are well worth it.” Remind the prospect that “If you pay peanuts, you get monkeys.” Good things are not cheap, and cheap things are not good.



Key Point: Handle price objections by increasing the client's perception of the value he or she would receive, not by reducing the price for that value.

Example: “Yes, Mr. Prospect, this project is a significant investment. However, in the final analysis, our services are worth what they can do for you, not what you have to pay for them. You are better off investing \$5,000 for accounting services and getting \$10,000 worth of benefits than you would be if you paid \$4,000 and got only \$6,000 of benefits.”

Sometimes, the prospect does not really mean this objection. It is pro forma. If it's not a big objection, just acknowledge that you are expensive, but do not defend or negotiate the price.

Sometimes you can ask the prospect “Why do you think it is too high?” Then you have something specific you can address. Or the prospect may respond, “I don't know. It just seems too high.” To which you could respond, “Well, it's not,” and go on to something else.

Generally speaking, compete on the basis of value and good service rather than on prices.


“Another Firm Will Do It Cheaper”

During the recession of the early 1990s, one of my clients reported he had quoted a monthly price of \$2,000 to a prospect. When the prospect replied that he had already talked to another firm that had offered to do the work for \$1,500, my client responded, “If price is all you are interested in, you could keep looking and eventually find someone who would do it for \$1,000 or \$1,200. But is that who you want giving you business advice? The cheapest CPA in town? Yes we are expensive, and our clients think we are well worth it.”

This firm’s market position was, “We are expensive and we are worth it. You have to pay more to get the best.” This firm’s market area was hit harder than average by this recession, yet the firm managed to make its way through the recession with profits intact. It is instructive that the firm did have to lay off some employees as its client base shrank. But by the firm maintaining the integrity of its pricing, the firm’s profits remained at the same high level as before the recession.

I had a client in the “rust belt” area of Northern England. This area was so depressed that it had never had less than a 14-percent unemployment rate in decades. This firm had been started by a sole practitioner whose marketing strategy was “choose us because we are cheaper.” He got clients by underbidding the other firms. In 10 years, he had built a firm of 3 partners and 30 staff using this strategy. After attending one of my profitability seminars, he went home and did the analyses in chapter 2 and 5 regarding how much money he was making and how to set the right prices. After discussing it with his partners, they decided that they would raise prices by 35 percent. They now faced a dilemma—for 10 years, their marketing had been based on price-cutting. Now, they would no longer be able to say, “Choose us because we are cheaper.” So what were they to do now?

By default, because they could no longer position themselves as the cheapest firm in town, they now had to adopt a marketing strategy of, “Choose us because we are better.” Surprisingly, in the next 18 months, in a severely depressed area, the firm grew to 50 people.

 **Key Point:** The firm’s marketing became more effective when it stopped competing on price.

Just because some people are having a recession does not mean that you have to agree with them and suffer a recession yourself. In even the toughest times, some firms grow and prosper. You could be one of those firms.



Chapter 7

How to Set Prices

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

Your time-keeping system should provide the following features:

- *Productivity* information by person—including chargeable hours, total hours, and comparison to target on a weekly or monthly basis
- *Realization* information by person—including the net effective chargeout rate attained after allocating write-downs to personnel who worked on the engagement, net revenue produced, and comparison to monthly targets
- Proper allocation of time charges to clients
- Proper allocation of write-downs to clients
- Proper allocation of write-downs to the responsible PIC
- Daily time reporting and daily invoicing² capability
- Automatic verification while inputting client numbers, work codes, and employee numbers
- Grouping related clients and treating them as one client for analysis purposes

¹ CPAs must comply with both the AICPA code and local state accountancy board regulations regarding fee arrangements. The AICPA rules may be found at www.aicpa.org/RESEARCH/STANDARDS/CODEOFCONDUCT/Pages/default.aspx. Links for state jurisdictions may be found at <http://nasba.org/stateboards>.

² This allows engagements which are completed early in the month to be invoiced within a day or two rather than waiting for the month-end WIP reports.

- Generating a list of clients and related cost and revenue information sorted by fees (ascending or descending), realization (ascending and descending), and the absolute size of write-downs (ascending and descending)
- Exporting appropriate files to your spreadsheet program for further analysis.

Many CPAs look at these criteria and think they will need new time-keeping software. Your current time-keeping system may provide most of these features. It might provide all, but you need to study the operating manual. Most systems generate far more management reports than you need. If your current system does not provide this information, invest in a new system; you will recover the investment quickly through more useful management reports. Numerous software products provide this information.

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

Chargeable Time or Billable Time?

Chargeable time is time spent which can be identified with serving a particular client, regardless of whether the CPA invoices the client for the time charges. Chargeable time measures the cost of serving the client.

Because accounting firms record time at standard rates, which include a standard profit, some accountants—especially less-experienced employees—are confused about the distinction between *chargeable time* and *billable time* based on whether they intend to send an invoice for the service. This confusion causes some professionals to think that if they are not going to invoice the client for the charges, they should not record the time.

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

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

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

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



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

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

If they don't intend to invoice the client for the work, they will not charge the time to WIP. For example, if they intend not to invoice the client for looking up an item in the file, scanning or copying it, and emailing it to the client, they record the time in a nonchargeable category (or do not record it at all). On another project, the CPAs might work 10 hours at \$250 per hour but intend to give the client a discount, so they only record 8 hours.

Again, this is a major cause of lack of profitability because these accountants lose track of the true cost of serving such clients.

On the other hand, if CPAs spend 15 minutes looking up some research they had previously done in 3 hours for another client, they may record 3 "billable" hours for 15 minutes' work, thus using the time-keeping system to record the price that they intend to invoice. But this also distorts the cost of serving that client and hides the fact that the CPA earned a write-up.

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

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

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

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

Five Factors That Affect Your Prices

The following five factors affect the amount you can charge for your services:

1. Demand for your services: There is more demand for automobile mechanics than buggy-whip makers. Market changes and technological advances affect demand. Demand for accountants depends on accountants' marketing success (for new business) and their success at managing clients (for the retention of current clients and the development of more business from them).

2. How easily you can be replaced: Garbage collectors are more necessary than doctors to the functioning of modern society. Yet, we pay doctors more because they are harder to train and harder to replace. For accountants, replaceability depends on market position (for getting new clients) and client management skill (for relationships with current clients).
3. Ability: This is similar to efficiency, meaning, “doing things right.” For accountants, personal expertise, time management skill, and employee training affect efficiency.
4. Return on investment of resources: This is effectiveness, meaning “doing the right things right.” An individual’s resource is his or her time. A firm’s resource is employee and owner time. Owners improve their return on investment with better time management, delegation, and supervision of employees.
5. Courage to demand what you are worth: You could have all four of the preceding factors under control and still not earn what you are worth unless you are willing to ask for and expect a fair price for your services. And you must have the walk-away power to not work for anyone who will not pay a fair price.

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

When to Use Value Pricing

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

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

The Value Gap

A partner in a very successful Canadian accounting firm told me this story (amounts have been adjusted for inflation):

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

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

I had just completed drafting invoices for a bunch of individual tax returns which totaled \$200,000. I looked at each draft again and asked myself how much each tax return was worth to the client, and—disregarding the time charges—I wrote most of them up based on value instead of standard fees.

Under the old system, I would have invoiced \$200,000. Instead, I added them up, and the new total was \$260,000, a 30-percent increase. I gulped, but each invoice was fair. I mailed them out and sat at my desk with my hand on the telephone waiting for (I thought) the inevitable complaints.

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

Another CPA from Dallas told me the following story (again I have adjusted the amounts for inflation):

I had a client with a closely held corporation that had a net operating loss. I prepared an application for quick carryback to get her a \$60,000 refund.

I had just attended a seminar on value pricing and decided to charge her \$5,000, three times my usual rate. I sent the refund form and my invoice in the same envelope.

She telephoned me in a couple of days. “I just got the tax form. Does this mean that I’m going to get back \$60,000?”

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


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

Why was this woman so happy to pay \$5,000 when the CPA was uncertain whether to charge more than his \$1,500 standard fee? Referring to the investment versus value comparison in chapter 1, “Pricing Methods in the CPA Profession,” the client focused on the “benefit, results, output, and return on investment”—the value side—the \$60,000 refund. The CPA focused on his “effort, input, investment, and time”—the cost.


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

Six weeks later the lady called me. “Jack, I just received my \$60,000! How much of that do I owe you?”

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

 **Key Point:** The simple truth is that most clients usually value your services more highly than you do.

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

 **Key Point:** CPAs are more price conscious than their clients.

One of my clients tells this story:

Over 30 years ago, when I was a new practitioner, I prepared a lady’s tax return. I considered the amount of time I spent and appropriate computer charges. I decided that \$400 was a fair fee and sent her an invoice for that amount.

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

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

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

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

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



Key Point: Often, clients do not know what your services are worth.



Key Point: Often, accountants also do not know what their services are worth.

The previous stories also illustrate what I call the *value gap*.



Key Point: *The value gap* is the amount which clients are willing to pay in excess of the amount which the accountant has the courage to charge.

Factors Affecting Value

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

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

Subjective factors which affect pricing include:

- Special capabilities, skill, and professional expertise of the persons doing the work: A person's standard chargeout rate for a service may not reflect that individual's special expertise in a specific industry. Even though a manager's regular rate for consulting is, say \$195, if the manager has special experience in the client's industry that makes the manager more valuable or efficient, you can justify a higher rate than standard.
- Degree of risk and responsibility assumed: Special services, such as the sale of a business and certain types of tax, management consulting, and specialist services merit higher prices. Likewise, if you face special risks (such as the possibility of not getting paid if a startup company fails), you can charge a risk premium. If you supervise a multidisciplinary team, or otherwise carry greater than normal responsibility, you should charge more. The intended use of the accountant's report, and the possibility of liability also may indicate the risk and responsibility of the services rendered.
- Seasonal factors: Using dual chargeout rates has some of the effect of seasonal pricing because a great deal of your tax work will fall in the busy season. Some firms

assign a busy season premium of about 30 percent to all work done between January 1 and April 15. Other firms might raise all rates 30 percent and then offer an “off-season discount” of 25-percent for work performed from April 16 to December 31.

- **Value of services:** Logically, prices should relate to the value of the service performed for the client. That value also reflects the degree of risk involved, and the nature of the services. Often, standard time charges for a service do not correspond to the value you create for the client. Obvious situations include negotiating a higher sales price or a lower purchase price for a client, savings in taxes, increases in revenues, strategic planning, obtaining financing, as well as other occasions when you help a client increase profits. A complicated tax settlement may depend on the accountant’s thorough knowledge and judicious reasoning to gain a substantial savings for the client. Remember that it is knowledge that creates the “value” in the value of the services, not time.
- **The amounts involved:** The size of the transaction also indicates the value. When you help a client with a multimillion-dollar factory financing, your services are more valuable than when you do a lease-versus-buy calculation on a 10-vehicle fleet purchase.
- **The results obtained:** Results are important in contingent prices or results pricing. Contingent prices are not allowed in all engagements or in all jurisdictions. Check your local laws. But even in regular engagements, you may subjectively consider the results you obtained for the client.
- **Priority and importance of the work to the client:** If the client asks to “jump the queue” and have you reschedule appointments or delay work for other clients to make room for his or her project, the price should reflect these special arrangements.
- **Loss of access to other markets:** If you have a client who doesn’t want you working with a competitor, or if you enter into a contingent price with a client that depends on increases in the client’s profits (as many of my consulting contracts do), you might be precluded from working with that client’s competitors or from performing attest services. If so, charge a premium price because you are foregoing other opportunities.
- **Working conditions:** If the client’s location makes your employees uncomfortable, and they don’t want to work there because it is noisy, crowded, or has lousy parking, the client should be required to pay more.
- **Special efforts required:** If you worked all weekend on an otherwise routine engagement because the client had an emergency, you should charge extra. Such extra charges are normal in business. Customers pay a premium for convenience and overtime for faster service.
- **Difficulty of the engagement:** If you have to move heaven and earth to accomplish the engagement, you deserve a bonus. Also, consider the time limits imposed by the client or the circumstances.

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


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

These engagements may have characteristics such as the following:

- Often, the client can measure the benefit. Examples are the reduction in a proposed tax assessment; the change in the purchase or sale price for a business; and revenue increase.
- The engagement involves a future orientation that will improve the client’s future welfare, such as helping set up a trust that will care for a disabled dependent after the client’s death.
- There is a multiplier effect whereby the client can profit repeatedly into the future such as negotiating a franchise or royalty agreement for a client.
- There is upside potential for a client. If the results of the engagement work well, the client may get even better in the future.
- Usually, the client does not have the necessary skill to do the work in-house.
- The client may have the skill but not the time. The client may have no one else in the company to fill in. If you represent a \$500,000-a-year executive and free up his or her time to pursue other pressing interests, that deserves more than \$300 an hour!
- The engagement is non-routine and requires high-level technical skill, business acumen, or mature judgment.
- No one else can do the job as well. If “no one else has it,” you can charge more.
- Special resources or contacts you may have or competency you possess: If you can solve an important problem with a telephone call to the right person, that creates incalculable value.

- Requires cooperation with others: If you have to quarterback a team, that commands more value.
- The application of knowledge, skill, or experience is the driving force which creates value, not the expenditure of time.
- The client is sensitive about the project, such as in the following situations:
 - The client's financial well-being or business is threatened.
 - There is an opportunity for the client to earn a windfall profit if the outcome is successful.
 - The client wants comfort. The client wants you to be involved even though someone else, either in the client's organization or outside it, could do it just as well.
 - The client's ego is involved. Some people will pay lots of money because they think the more they pay, the more a thing is worth.
- Other professions charge for value when doing this. How would a lawyer charge for this? A real estate broker? A financial adviser?
- The amount of money involved is relatively large. The client may have substantial amounts of money at risk and depend on your skill to affect a favorable outcome.

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

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

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

Arranging Payment With the Client

All clients are willing to pay a fair price. Of course, if you come across one that won't pay a fair price, he or she becomes a former client. Accountants often lose sight of the fact that clients do not want to cheat you any more than you want to cheat them. Clients want you to earn a fair fee. Many accountants report that, on occasion, they have submitted an invoice to a client and the client told them to charge more. Most clients are quite willing to pay a fair price because they know you must earn a living just like they do. Their chief concern is that other clients pay comparable prices.

Example: After their managing partner attended one of my seminars, one firm raised standard rates across the board by 30 percent.

They lost less than 2 percent of their clients.

The managing partner reported this typical incident:

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

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

What sort of financial arrangements, if any, must you make with the client before value pricing? Even in routine engagements, allow for value pricing in the *engagement letter* terms. This is covered in chapter 13, "Get It in Writing."

If value pricing opportunities arise, discuss the price before you begin work. Then you can obtain the client's agreement about how to price the engagement.

When to Use Results Pricing

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

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

Results pricing is not a gratuity you add on for extra special service. That is value pricing.

It is not invoicing an engagement with \$2,657 in WIP for \$2,750. That is normal invoicing practice.

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

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

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

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



Key Point: You cannot control the client's perception of your value retroactively. You must do it up front.

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

When to Use Fixed-Price Agreements

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

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

Fixed-price agreements communicate confidence. An up-front quote projects confidence, experience, and competence on your part. It also contains the seeds of disaster, if you are not careful.

How long could a restaurateur remain in business if he or she said, "I will feed you for \$600 a month"? How long would it take before the customers began to come in every day, and then every meal? Soon they would begin to order Lobster Newburg and an expensive wine. And if the restaurateur put up with that, then the customers could start to invite their friends to join them. And all for the same \$600!

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

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

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

Example: My wife and I built a house in 1998. The original contract was for about \$320,000. It was a fixed-price agreement, but we wound up paying far more than that. Why? We added extras such as a larger bathtub, a swimming pool enclosure, crown molding, extra cabinets, and so forth. The original contract was accompanied by a set of plans and specifications. Anything extra was extra. And for each of these extras, the contractor had us sign a change order.

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

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

Play the offense, not the defense. That's good advice in lots of areas.

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

I once knew of an audit partner with a big national firm that could lowball an audit for \$50,000 and count on getting \$80,000 from the extras. No scope creep for him!

Packaging Your Services

Have you noticed that some of the most valuable services accountants provide clients—suggestions for improving their businesses and suggestions that develop in the course of other engagements—are often given to the clients for free? Have you also noticed that these valuable suggestions are just as often ignored by the clients?

As discussed earlier, CPAs often discuss business improvement ideas informally when they deliver tax returns or financial statements as an extension of the regular compliance engagement. They do not structure the advice as a separate service.

As a result, they donate these valuable ideas to clients because they were developed incidental to the compliance engagement. Because CPAs invoice the clients for the originally agreed-upon engagements, it doesn't seem fair to charge clients for this additional advice. And besides, the clients didn't ask for the advice, we simply offered it, which most CPAs consider part of "going the extra mile for clients."

Sound familiar?

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



Key Point: People do not value that which they get for free.

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

Exhibit 7-1, "Sample Language for Packaged Services," is an example of how to turn your service into a product and quote a fixed price. This example takes the form of a section on the firm's website describing an accounting firm's packaged services.

Exhibit 7-1: Sample Language for Packaged Services

Growing Your Business

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

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

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

Four Levels of Business Service

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

Bronze Service: Compliance Reports

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

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

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

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

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

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

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

Silver Service: Management Accounting

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

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

Typical prices for this service range from \$____ to \$____ per month.

Gold Medal Service: Management Advice

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

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

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

Typically, the price for gold medal service ranges from \$____ to \$____ per month.

Platinum Performance: Chief Financial Officer Service

At the *platinum level*, our team performs much like the Chief Financial Officer of a large company—the type of high-level professional capability that small and medium-sized businesses could not otherwise afford.

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

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

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

The typical price for platinum service ranges from \$____ to \$____ per month.

* Some firms prefer to say "key performance indicators" (KPIs).

Packaging services like this create more value than the standard rates of the chargeable time invested. Many accountants report that some of the clients they had thought were most price sensitive have chosen gold or platinum level service when given the opportunity.

Here's how you can apply the packaging concept to individual clients. Exhibit 7-2, "Sample Letter for Promoting Packaged Services to Individual Clients," is a letter sent out in November or December.

Exhibit 7-2: Sample Letter for Promoting Packaged Services to Individual Clients**Three Levels of Individual Services**

Good morning [*Client name*]

Fall is here.

And 20XX is just around the corner.

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

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

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

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

Now, you tell us how to best fit your financial and service goals...

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

1. **Mail Service:** No interview is needed and we answer any questions about your returns by phone, email, fax, or mail throughout the year. Please let us know if your questions can be addressed after April 15 so that we can serve you best. Your investment for the Mail Service is \$____. (**Author's note:** This would be your minimum or the amount the client paid last year for the interview service, whichever is more.)
2. **Team Service:** One of our highly qualified team members will conduct your in-person interview and take responsibility for your returns to provide you with the service level you desire. Your investment in the Team Service is \$____. (**Author's note:** This would be about \$200 to \$300 more than Mail Service, depending on your personnel situation and how badly you want to free up owner time.)
3. **Partner Service:** The partner of your choice will conduct your in-person interview and oversee your returns from start to finish. Your investment in the Partner Service is \$____. (**Author's note:** This would be about \$300 to \$400 more than Team Service, again depending on your personnel situation.)

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

We agree, no one likes to pay taxes.

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

1. We will act with integrity, honesty, and openness in everything we do.
2. We will respect the confidentiality of our working relationship.
3. We will return your phone calls within 24 hours. (**Author's note:** You might say "within one business day.")
4. We will meet the deadlines we set (and, in the case of extenuating circumstances outside our control, we will let you know well in advance of our dilemma).
5. We will honor your right to know in advance our price for any assignment.

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

1. You will do your best to accumulate your tax information in a timely and orderly manner.
2. You will keep your appointment or give as much notice as possible if you need to reschedule.
3. You understand that we will not schedule appointments between April 1 and April 15.
4. You will try to avoid extensions when possible and you understand that if extensions are necessary due to your individual circumstances, additional charges may apply.
5. You understand that one-half of your payment will be due upon receipt of your tax information and the rest is due upon delivery of your tax return. (**Author's note:** If you cannot yet bring yourself to commit to a fixed price or to collect money in advance, then say, "You will pay your account on a regular monthly basis, within seven days of receipt of our invoices.")
6. You understand that if your current year invoice is not paid by June 30, 20XX, the next year must be prepaid.

We at [firm name] believe that these commitments, on our part and yours, will enable us to provide you with the timely service that you look for in tax preparation.

And, if you are not delighted with our service, you, as the sole judge of our performance, have the right to withhold any payment. All we ask is that you honestly tell us where we have fallen short in your eyes so we can learn and improve from the experience.

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

Sincerely,

The team at [firm name]

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

How to Adjust Prices Upward

Suppose, after performing the analyses in chapter 2, "How Much Do You Really Earn?" you decide your prices are too low. (When you discuss prices with clients, you never raise prices, you always adjust prices.) So, how do you adjust (raise) them? You raise prices by raising prices.

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

Example: You charged Clark Client \$475 last year, but after reading this book and looking back at the value of what you did, you think you should have charged \$750. If Clark's past record holds, this year will be even more complicated—perhaps to a fair price of \$800 or more.

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

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

It's as simple as that.

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

Do you have to notify your clients? No.

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

How to Make “Balanced” Changes

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

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

1. **Current Realization Less Than 80 Percent:** If your current realization is less than 80 percent, an increase in chargeout rates may not be necessary, provided you target an immediate increase in realization of at least 10 percent every six months until you reach 80 percent.

2. **Current Realization Above 80 Percent:** If your current realization is over 80 percent, your entire increase in effective chargeout rates should come from raising rates. Let your realization remain where it is or even drift a little lower as long as it remains above 80 percent.

My empirical observation is that CPAs earn the highest effective chargeout rates with higher standard rates and realization somewhat above 80 percent. I usually recommend my CPA firm clients target about 85 percent.


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

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

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

One client couldn't bear to raise rates all at once. So the firm raised partner rates 20 percent and employee rates 10 percent on October 1. Then the firm raised all rates a further 10 percent on January 1. The firm's realization remained above 98 percent.

Remember, most people equate high prices with high quality, especially if they have little else by which to judge value. Generally, the more people pay for something, the more valuable it is to them. Because professional services are an intangible that most clients cannot evaluate, they often evaluate them based on what they pay.

 **Key Point:** It sounds contradictory, but you can increase your value to clients by simply raising prices.

Unleash the Power of Unconditional Service Guarantees

You may have noticed the 100-percent satisfaction guarantee in exhibits 7-1 and 7-2. If you take the risk, clients will pay you more. In fact, you guarantee satisfaction anyway, don't you? Why not turn it into a marketing advantage.

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

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

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

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




Chapter 8

How to Discuss Prices With Clients

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


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

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


 **Key Point:** If goods and services are being sold, the seller has the responsibility to mention the price first.

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


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

 **Key Point:** Clients are embarrassed to discuss price. They are relieved if you bring up the subject.

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


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

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

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

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

Train Clients to Pay You Well and Promptly

 **Key Point:** Clients will treat you the way you train them to treat you.

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

Example: One firm normally invoices by the third workday of each month. The firm explains to clients that it expects payment before the end of that month. This way, if the firm prepares a list of accounts receivable at the end of any month, the client's name never appears. At the beginning of the month, the client's work is still in WIP; by the end of the month, it has been paid.

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

Then follow up. Observe when clients pay. If they pay you in accordance with your agreement, send them a note or email the first time, thanking them for their business and for paying on time. Then they know that you will be watching them.

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

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

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

What "How Much Is This Going to Cost?" Really Means

I covered this briefly in Chapter 6. This question is so important that I want to re-visit the subject now.

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

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

Many accountants get a tight feeling in their chests when they hear this question. Some feel queasy and a few even have physiological reactions. All sorts of fearful scenarios can run through your mind. You might wonder, "If I quote an estimate \$100 too high, will they shop my price to other accountants?" If the questioner is a current client, you might wonder, "Don't they trust me anymore?"

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

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

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

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

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

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

Why did I complain? Did I think Yale had ripped me off? No.

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

"Yale," I said, "how much is this going to cost?"

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

Why, then, did I ask about cost this time when I did not ask before? Was it because the window repair invoice was higher than I expected? No. That repair had cost just about what I had anticipated.

Then why had I complained?

I complained about the price because it's my job (as a customer) to keep Yale (as a supplier) on his toes.



Key Point: I wanted Yale to think I was price-sensitive even though I was not.

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



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

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

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

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

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

1. A person might want to know his or her options. For instance, was the problem with the right front wheel of my car covered by warranty? Should I have gone to the auto dealer or the tire dealer? If the problem was extremely serious, might I even trade-in the car instead of fixing it? Because I did not know, I asked, "How much is this going to cost?"

2. An individual might ask what the cost is to make sure he or she can write the check. Sometimes, an individual has to postpone expenditures until payday, or arrange to increase the credit line on a credit card, or make other arrangements. In other words, the person wants to be sure he or she can pay the invoice.
3. A buyer asking, “How much is this going to cost?” signals to the seller that the buyer does not have a blank check. It is a not-so-subtle indicator to the seller that, “I am not made of money. I am sensitive to cost. Do not try to take advantage of me.”
4. People want to appear more knowledgeable than they are. A client may ask about cost even though he or she has no idea how much a fair price is.

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

Asking “How much does this cost?” does not mean that the client intends to shop your price. It does not mean the client doesn’t trust you.

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

Turn a \$438 Sale Into a \$238 Sale Without Really Trying

My wife wears designer glasses. They are made of a space-age plastic with rose tinting, fluted edges on the lenses, gold frames, and soft nose pieces. They are not cheap.

Many years ago she needed new glasses. Here’s what she told me when I came home from work:

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

I told her, “That’s more than I wanted to pay.”

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

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

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

I bought the glasses and saved \$200.

Let’s look at what happened here:

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

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

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

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

Do you have clients like my wife?

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

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

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

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

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

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

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

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

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

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

Do you have any clients like me?

"If you don't ask, you don't get." I asked for a discount and I got it.



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

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

The records she brought me were a mess. When I finished, my time charges at standard came to £1,400. I looked at that amount and panicked. I told myself she would never accept a fee that high. So I only charged her £660. Listening to you, I kick myself because now that client thinks she can bring me that same mess this year and pay only £660.

The countermeasure was right in front of the accountant—all he had to do was discuss the price with the client either as soon as he saw the mess and before investing £1,400 of time, or even after he did the work but before he delivered the product and the invoice.

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

Don't Make It Look Too Easy

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

A British chartered accountant was once the controller of a Dutch manufacturer. He told me this story in the mid-1990s. Prices have not been adjusted for inflation:

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

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

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

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

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

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

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

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

The president paid the invoice.

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

Your Pricing Communicates Your Value

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

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

"Thanks, but why call me now?"

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

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

"You were the most expensive, and we want the best."

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



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

If you price your services at the low end of the market, clients may perceive you as "just another CPA" and may not take you seriously. If you are expensive, not only will they respect you, but they are more likely to implement your recommendations because they paid so much for them.

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

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



Key Point: The more people pay for something, the more valuable it is.

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

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

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



Key Point: What you say with confidence, they will believe!

As I said earlier, most clients will pay a fair price. But they want to know that other clients pay comparable prices. Periodically reassure your client that the firm charges all its clients fairly—not cheaply, but fairly. If you offer a discount to one client, other clients may find out and want a similar discount.

How to Use “Cottle’s Law” and “Cottle’s Corollary”

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



Key Point: A client’s problem is always bigger to the client than it is to you.

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


Many accountants have a knee-jerk reaction: they pooh-pooh the client’s problem. They say, “Don’t worry about it. It’s no big deal; we handle difficulties like this all the time.”



Key Point: If you minimize the size of the problem, you minimize the value of your solution.

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


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

 **Key Point:** Knights earn more for slaying dragons than slaying coyotes. And I might repeat what I said earlier—gunfighters don’t get paid by the bullet!


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

Why do some CPAs paint themselves into a corner, minimizing their own value by minimizing the problem? They do it because they want to ease the suffering of their clients. Humans naturally want to comfort the suffering of even complete strangers. So it’s no wonder that CPAs feel that way about sufferers who are their friends and clients.

The problem is that when the CPA alleviates suffering by minimizing the client’s perception of the size of the problem, the CPA also downgrades the client’s perception of the value of the accountant’s contribution.

 **Key Point:** The value of the solution varies with the size of the problem.

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

 **Key Point:** *Cottle’s Corollary*—The bigger the problem, the more valuable the solution.

Yes, it’s okay to make clients feel better, but don’t do it at the cost of losing your profit.

There is a way to make clients feel better without minimizing your own contribution. Build up the value of your contribution instead of minimizing the client’s problem. Your message should be, “Yes, you have a serious problem. But we have lots of talent in the firm and I’m confident that we can solve your problem, or at least mitigate some of the damage by applying some of our firm’s talents. Yes, it will cost you some money, but that’s what money is for.”

With some problems, if the client asks about cost, you can answer, “If we get a few breaks, maybe nothing! It’s possible that the tax savings [or other outcome] may be more

than your investment in our services. In other words, we may be able to pay for our services by the savings we will generate for you.

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

The Problem With Price Estimates

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

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

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

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

How to Avoid Professional Panic

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

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

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

“I don’t know.”

“Could it be as many as 100?”

“Oh, I’m sure it’s more than that.”

“Okay. Could it be 200?”

“No, I think it is more like 150.”

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

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

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

“That’s right.”

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

Yet the fact remains that the vast majority of your clients are happy with your prices. As I said earlier, over 90 percent come back year after year. Many CPAs report over 95-percent client retention each year.

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

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

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

These commodity shoppers are a small part of the market for your services. They may be 2 percent or 10 percent, no one knows. The size of this market segment changes according to economic conditions and competition, including the competition from non-accountants such as bookkeeping and income tax services.

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

Whatever the reason, some firms then panic and go after the real bottom end of the market. True, an accounting practice can cover a fairly wide market. Nevertheless, it cannot cover the equivalent of a Korean sub-compact listing for under \$10,000 on the one end and Rolls-Royce on the other.



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

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

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

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

Ask for a Deposit

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

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

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

“In your case, that would be about \$____.”

Again, pause for the client’s reaction.

Be Flexible

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

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

The Preferred Client Approach

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

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

Five Important Tools in Negotiating Prices

The following are important tools in negotiating prices:

1. Consider Who Initiated the Negotiation

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

2. Understand the Anchor Effect

Using shortcuts (such as standard rates) creates problems in decision making. Most people, consciously or unconsciously, start with a number that comes easily to mind. Call that the “anchor.” For CPAs, that is the WIP run from their time-keeping system. Then people try to adjust up or down from the anchor to reflect significant factors other than the anchor. While this procedure seems sensible, it suffers from a major defect: people usually adjust insufficiently. The initial number (that is, the anchor) affects the CPA’s mind and keeps the final price from moving as far as it should from the WIP report. Once the CPA sets the anchor, the decision-maker demonstrates a bias toward that value.

I have tested the anchor effect with accountants on more than a dozen occasions. See exhibit 8-1, “Sample ‘How Would You Price This?’ Quiz.” I give seminar participants hypothetical facts on an engagement. I include what the accountant did, which personnel worked the engagement, their compensation, and the number of hours they required. All facts are identical. The fact sheets also say, “The standard charge for the engagement is \$_____.” Half the sheets show the standard charge as \$4,042.25 and half as \$5,622.25.

Exhibit 8-1: Sample “How Would You Price This?” Quiz

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

How Would You Price This?

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

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

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

Description	Annual Compensation	Standard Charge-out Rate	Hours	Amount
Owner	\$90,000	\$	10	
In-charge (3 years' experience, certified)	42,000	\$	20	
Staff assistant (18 months' experience, noncertified)	37,500	\$	20	
Typing and checking	22,000	\$	10	
100 photocopies				
Mailing reports and returns				12.25
TOTAL PROPOSED INVOICE				

How Would You Price This?

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

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

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

Description	Annual Compensation	Standard Charge-out Rate	Hours	Amount
Owner	\$90,000	\$	10	
In-charge (3 years' experience, certified)	42,000	\$	20	
Staff assistant (18 months' experience, noncertified)	37,500	\$	20	
Typing and checking	22,000	\$	10	
100 photocopies				
Mailing reports and returns				12.25
TOTAL PROPOSED INVOICE				

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

Let's relate this to the real world.

The following story is almost too good to be true, but I swear this is the truth, the whole truth, and nothing but the truth, as told to me by Jim himself about 20 years ago. The amounts have not been adjusted for inflation.

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

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

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

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

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

The husband asked me, "How much is your daughter's tuition?"

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

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

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

Dave, I learned a valuable lesson here—never forget anything you tell me.

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

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

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

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

3. Ask, "How Much Have You Budgeted to Solve This Problem?"

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

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

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

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

4. Ask, “If I Can Pull this Off,¹ How Much of the Savings, Extra Money, etc. Are You Willing to Split With Me?”

When I say the word split, what amount comes to mind? That’s right—50 percent.

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

One of my clients told me this story:

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

“\$1,600,000,” he answered.

He was a very good client and a very good friend. I told him, “Your business is worth a lot more than that.”

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

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

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

“You’re right,” the client answered.

5. Relate the Price to the Amounts Involved

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

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

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

¹ Or whatever the engagement is, such as “reduce the taxes,” or “get you more than your current asking price for your business.”

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

Alan referred to his WIP report from his time-keeping system and learned he had invested \$35,000 so far in the engagement at standard rates. Because of his unique skills, Alan realized that the deal would not have occurred without his efforts. Inspired, he told the attorney: "One-quarter of one percent." That is \$125,000.

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

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

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

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

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

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

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

The bank's attorney asked, "Alan, that seems a little high. Has Paul approved this?"

"No," Alan answered. "I hadn't even thought about the fee until you asked."

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

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

"Well," Paul answered, "If it's okay with the bank, it's okay with me."

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

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

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

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

The beautiful thing about this approach? It focuses the client’s attention squarely on the outcome rather than the cost.

How to Handle Price Objections

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

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

Instead, just ask them the following question:

“Do you know what it will cost you if you don’t do it?”

For estate planning, you may joke that it won’t cost them anything; it will cost their kids. If the client continues to object, then inform him or her:

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

This again places the client’s attention on results instead of the cost.

Then tell the client what he or she will gain, depending on the nature of the engagement—succession planning, retirement planning, a new accounting system, or whatever. Paint a vivid picture of how rosy the client’s future can be if he or she solves this problem.

Alternatively, you might paint a picture of how bad it could be if the client does not solve the problem.

Keep the client thinking about what he or she will gain or save, not about your price.

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

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

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

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

How to Handle Procrastinators

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

Say this:

“If anything happens to you between now and then, I would hate myself for letting you delay. Changes in your circumstances could foreclose some options you now have; they would no longer be available. The longer you wait, the more risk you take that you will be left with fewer choices. You may lose a key employee, your building could catch fire, you could become uninsurable, or you might get disabled.

Who knows what the future holds? You will sleep better at night once you handle this. Do it now.”

How to Handle Price Complaints

So what about the real complaints?

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

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

Most accountants are spring-loaded in a defensive posture. Touch them anywhere and they withdraw into their defensive shell—especially when it comes to their prices. Typically, when a client questions a CPA’s invoice, he or she reaches into the briefcase, pulls out the time run, and waves it under the client’s nose, exclaiming, “I even wrote it down!”

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

I looked the client in the eye. I smiled in a friendly and confident manner. And I asked him, “Why do you think the price is too high?” You see, I put the shoe on the other foot. I played offense, not defense.

He hemmed and hawed and stuttered and stammered for a bit. Finally he said, “It just seems too high.”

So I replied, “Well, it’s not.”

And that was the end of the price discussion.

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

For real complaints, you should still ask my mentor’s question, “Why do you think it is too high?” In 9 out of 10 cases, if a client does complain about a price, the price is not the

real problem. The problem is some aspect of the service. Perhaps a late report, a telephone call or email you didn't return, an appointment you missed, and so forth. But the client doesn't know how to articulate the real complaint and so the price becomes the focus.

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

Example: A client is contemplating a \$1 million transaction that can have significant tax ramifications if not handled correctly. You suggest that you want to research the tax treatment to see whether there might be a more tax-favored way to do the deal. After \$3,000 of research, you discover it doesn't matter. You charge the client \$3,000 and she complains.

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

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

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

Here's how to respond in this situation:

Yes, we didn't find anything. But that is also valuable. Think of the research like an insurance policy. At the end of the year, if your house didn't burn down, do you think the insurance was a waste of money? Of course not. We invested this \$3,000 to protect your \$1 million investment in this transaction from adverse tax consequences.

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

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

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



Chapter 9

Build a Better Firm With Better Clients

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

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

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

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

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

Why Are You in Business Anyway?

If you're like most accountants, your goals for your clients go far beyond the routine services of keeping them in compliance with tax laws and reporting on financial statements. In fact, I recommend my clients use an integrated approach to marketing and delivering a full range

of financial supermarket services which I call four-dimensional client service. This enables CPAs to guide their clients to achieve a more comfortable current lifestyle, a financially secure retirement, and the transfer of the maximum accumulated wealth to clients' heirs and favorite charities.

Here is four-dimensional client service in a nutshell:

1. The first dimension is traditional compliance services: write-up, accounting, attest, compilation, and tax preparation.
2. The next dimension is increasing the client's current income: tax planning, tax-favored investments, business advice, cash flow planning, asset protection, and investment advice and management.
3. The next dimension is to help the client achieve a financially secure retirement: tax-favored investments, business exit strategy, asset realization, personal financial planning, investment advice and management, and asset protection.
4. The fourth dimension is for the client to pass maximum wealth to their heirs or charities: asset protection, estate planning, and business succession planning.

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

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

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

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

Let's see how many of the following statements apply to some of your clients:

- Some people don't want a better future. They never think beyond their next paycheck.
- Some people wish for a better future, but they won't do anything to get there. They have self-destructive habits, but they choose not to change them.
- Some people are not willing to pay for help in reaching their goals. They want something for nothing.

Fortunately, it is a small number of clients who cause you grief. If your goal is to maximize revenues, then you put up with it. But if your goal is to enjoy your practice and maximize your service to your good clients (and, as a result, make a good profit on a long-term basis), you will discard your worst clients each year. Some accountants review their clients in terms of the hassle factor and costs that were not included in the original agreement, and either renegotiate or terminate the relationships. One financial planner and investment manager has an explicit policy to get rid of the worst 10 percent of his clients each year.

In fact, you probably have several clients who, when you think about them at all, you say to yourself, "If I had known then what I know now, I would never have gotten involved with them."

You can know ahead of time about potentially troublesome clients so you can avoid them in the first place.

How to Recognize a Good Client

“The man who chases two rabbits catches neither.”

—Confucius

Arsenio Hall once asked Bill Cosby for his secret to success. Bill replied, “I can’t tell you a sure way to be successful. I can tell you that the sure way to fail is trying to please everybody.”

What makes a good client? It is important to define what makes a good client for your firm. The following three steps can help:

1. Consider your own standards in the following areas (add any areas you think are relevant):
 - a. Amount of annual purchases
 - b. Promptness of payment
 - c. Growth potential
 - d. Referral potential versus actual referrals
 - e. Profitability of serving client (write-downs and write-ups)
 - f. Risk of litigation or damage to your reputation
 - g. Fiscal year (when the work is done)
 - h. Fun to work with
 - i. Asks your advice when they should
 - j. Takes your advice when you give it
 - k. Other items you think relevant
2. The best way to grow is to “clone” your best clients. Look at your 10 best clients. What characteristics do they have in common? List them.
3. What makes a not-so-good client? Consider the previous items and any others you think are relevant. Now you have a clear definition of what to look for and what to avoid in future clients.

One firm I worked with several years ago, which had fewer than 10 full-time equivalent personnel when we started, had more than 180 corporate clients. The 67 largest corporate clients accounted for 92 percent of total revenue. The 82 largest corporate clients accounted for 95.42 percent of total revenue. In other words, their 100 smallest corporate clients accounted for less than 5 percent of total corporate revenue.

They had 310 individual clients. The 134 individual clients who paid the most accounted for 78 percent of the total 1040 revenue. In other words, their 176 smallest individual clients accounted for about 22 percent of total revenue.

Their firm is typical of many firms I work with.

Here is the advice I gave them:

What does all this mean?

First, it means you could raise your minimum annual fee for individual clients to \$____. If you lost all clients paying less than that, you would do 176 fewer returns and the revenue loss would be immaterial. Plus, with more time to spend with the remaining clients, you would probably enjoy an increase in VAS.

Second, it means you could raise your minimum annual fee for corporate clients to \$____. If you lost all clients paying less than that, you wouldn't even notice the revenue loss. Plus, with more time to spend with the remaining clients, you would probably enjoy an increase in VAS.

Practice Tip—The firm should target high-income and high net worth individuals and owner-managed businesses. It should continue to serve governmental, non-profit and other clients who do not meet that target—provided such clients are willing to pay prices that allow the firm to serve them profitably.

Practice Tip—Upgrade unprofitable clients and, with the small number of clients who fail to upgrade, terminate approximately 100 of your small individual clients and approximately 100 of your small corporate clients.

Would this advice apply to your practice?

Your firm may not be losing money directly on servicing these smaller clients, but there are several reasons you should consider terminating them:

- These clients often demand a lot of compliance work which is low-profit and which distracts the firm from seeking opportunities for more profitable value-added services for its better (usually larger) clients.
- The work these clients demand is often boring, leading to low morale among your employees.
- These clients require a higher percentage of owner time than larger clients, making it harder to leverage the owners.
- The revenue loss would be immaterial. Plus, with more time to spend with the remaining clients, you would probably enjoy an increase in other more valuable services such as estate planning, financial planning, and business advice.

Your market position should be, “Yes, we are expensive, and our clients think we are well worth it because we do more than just compliance work.” Never compete on price. For prospects who seem extraordinarily interested in low prices, you should respond:

Perhaps you would be happier elsewhere. Our clients view us as an investment, not an overhead.

This exclusivity allows your owners and other key employees to devote more time to deepen the relationships with your best clients.

The results may startle you.

Example: Another one of my clients in Ohio found that the smallest 40 percent of its clients accounted for only 4 percent of revenues. I encouraged my client to increase owner rates 32 percent and employee rates 21 percent. The results were dramatic. How dramatic? Within two years, my client increased net income per owner by 67 percent.

And it all starts with client evaluation and client pruning.


When looking for people whom you want to help, you will run into all types of people. Because you have only so much time on this earth, it makes sense to spend it with people who will make smart choices about their business and personal finance. It's smart to walk away from people who won't be good clients.

Based on 30 years' experience as an adviser to accountants, it is clear that this means going after the premium clients—people who want the best advice and will pay for it.

But what about the clients you already have? Have you accumulated some losers? It's easy to do. If you're like most CPAs, you have been in practice for a few years and you are now quite busy. Even in the summer months, most CPAs tell me that it would take them two or more weeks to catch up with their current work even if no more new work came in. In other words, they have a two-week backlog even at a supposedly slow time of year.

If that description fits you, then maybe it's time to be a little more selective about who you will accept or retain as a client.

If so, it's time to cull the herd.

 **Key Point:** Whether you realize it or not, if you are busy, you are auctioning off a limited amount of your services. Sell them to the highest bidder.

A number of you reading this book have never shown a client the door. I guess we all hope that problem clients will somehow become easier to handle in the future. Or maybe we think it's our fault. Well, that's just not true. If the client is difficult, move on. You are highly skilled at your profession; if things aren't working out, you know it must be the client's fault.

The solution to having bad clients is to terminate them or train them to be better clients.

Evaluate Clients Realistically

Often, a large part of client relations problems and other practice problems originate with a small number of clients—clients who may also be the least profitable ones. Also, accountants often find that a high percentage of write-downs comes from a small number of difficult clients.

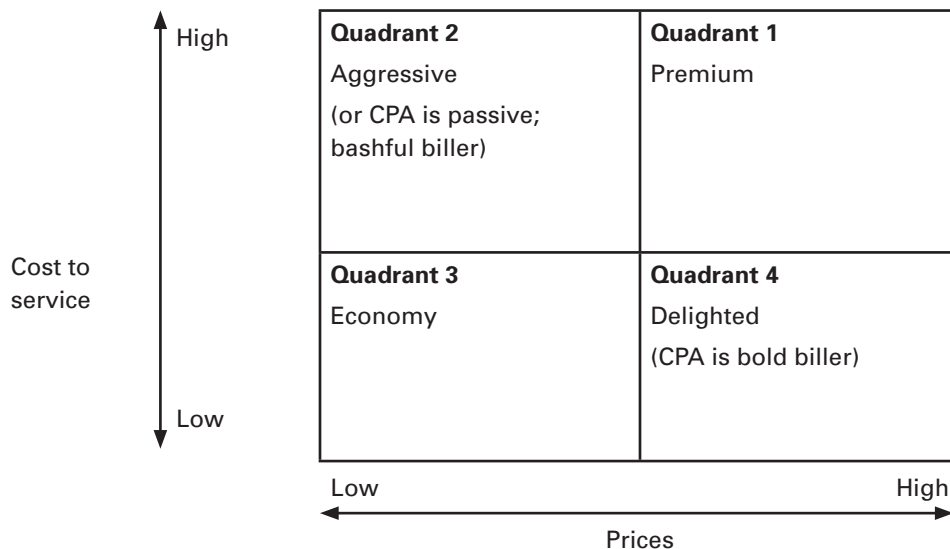
As discussed earlier, the best clients realize that your fees are not overhead (which will reduce their profits), but are investments—which will enhance their profits, either directly or indirectly.

There are many ways to evaluate your clients. Here are just two ways:

1. Begin your evaluation by preparing a list of all clients in descending order of fees. Treat related entities as a single client for purpose of this analysis. Draw a subtotal at the smallest client included in the top 80 percent of your revenue. See what your average effective rate per hour is for those larger clients. Compare it to the rest of your clients. Any client with an average hourly rate of less than the 80 percent of the larger clients is a candidate for culling.
2. Here's another analysis: because you have hundreds of clients, most of whom have write-downs, trim your list to a manageable number. Sort the list in descending order by absolute amount of write-downs. Focus first on clients with write-downs of over \$1,000 and with realization of 10 percent or more below the average for your firm. For example, if your average realization is 90 percent overall, focus first on those clients with both write-downs exceeding \$1,000 per year and realization of less than 80 percent.

This should give you a manageable number of clients to work with. Analyzing those clients for corrective action. To oversimplify, let's divide clients into four classes as shown in exhibit 9-1, "Client Classification Matrix."

Exhibit 9-1: Client Classification Matrix



Let's look at each of these four classes in turn:

1. **Premium Clients:** Certain clients are costly to service but will pay a fair price. They go first class and are willing to buy the ticket.
2. **Aggressive Clients:** On the other hand, some clients demand costly services, but don't want to pay for them. They negotiate on prices and get bids from competing firms.

These clients are aggressive. CPAs are, by nature, risk averse. We tend to avoid conflict, especially with clients. This manifests as a lack of confidence. Clients often sense this and—because they negotiate every day in their business—use our lack of confidence to beat us up on price.

But when I review the invoicing of CPA firms, I often find many clients who are costly to service and who pay low fees but who are not aggressive negotiators when dealing with their CPA. They pay low fees simply because the CPA charged them lower prices than the CPA should have. In this case, the client is in the upper left quadrant—not because the client is aggressive, but because the CPA is passive. In fact, the CPA may never discuss prices with these clients. The accountant does not engage the client in a discussion of the account and its lack of profitability. The accountant is a bashful biller who seldom discusses his or her prices with clients! Many of these accountants discuss prices only if clients broach the subject.

3. Economy Clients: Most accountants also have clients with either limited means or economical tastes who don't ask for much and don't pay much.
4. Delighted Clients: Most accountants also have clients who are extremely satisfied with their services and will pay almost any invoice their accountant submits without thinking about it. These delighted clients may be small or large; the distinguishing characteristic is their high level of satisfaction and their ability and willingness to pay good prices.

For most CPAs, over 90 percent of their clients are delighted, based on the percentage who return year after year—even many of the ones in quadrant 2.

I want to stress that delighted clients in the low-cost, high-price corner are not sheep; they are very happy and the accountant is a bold biller on those clients. The accountant takes appropriate consideration of the clients' high level of satisfaction to charge good prices.

Fortunately, the vast majority of clients love your service and will readily pay more if you approach them right.

But I will begin with the worst ones.

Pick Your Five Worst Clients and Fire Them or Upgrade Them

How do you usually get rid of clients?

You may occasionally just “bill the client out the door” by sending him or her an invoice so high that the client can't stand it. I advised against this earlier. As one CPA put it, “Bill 'em till they bleed!” But your disgruntled former client may tell people that you tried to gouge them. Besides, then it is the client's decision to leave, not yours. The clients are cause and you are effect. That's no good for your ego. If you ran the clients off, you get emotional points for courage. Finally, your employees will respect you more if you take the initiative to cull unsatisfactory clients.


You can also just send the clients a termination letter without explanation. Then the clients feel betrayed and abandoned. Again, you have unhappy former clients who are likely to tell others how they feel.

There is no point in making unnecessary enemies.

There is a low-risk way to either upgrade these clients or else get them to leave your firm on good terms. I call it *Cottle's Apple Pie*. Like a recipe, you must follow it exactly if you want to get the best results. Don't get creative until you've baked the pie at least five or six times; then you can experiment.

If you change any part of my recipe, your results will be different. Maybe better, maybe worse—but certainly different. If you try just part of the recipe and don't get good results, don't blame me. It won't be *Cottle's Apple Pie*; it will be yours.

The idea is to take your clients in the aggressive quadrant of the client classification matrix and move them over to “premium” by increasing their prices, or down to “economy” by reducing your costs.

 **Key Point:** It is very risky to try to move a client from quadrant 2 “Aggressive” to quadrant 4 “Delighted” at one encounter. Either move them to quadrant 1 “Premium” or quadrant 3 “Economy”, preferably quadrant 3.

Using this method, one South Carolina CPA firm upgraded 24 out of 24 bookkeeping clients from unprofitable to profitable. Another accountant in Britain used this with 13 clients, and upgraded 12 and terminated 1. I can practically guarantee you that your profits on the affected clients as a group will be larger after you do this process than they were before.

But you have to follow the script the way I've written it? Got that?

1. Pick five small clients you are better off without. These should be small enough so that you would not miss their revenues if they were gone. Don't do this with major clients, no matter how unprofitable they have been; the risks are too great. Start with small clients, get good at handling them, and then move up to the larger clients. Think of these five small clients as exhibition games. Practice on them, then you can handle larger clients easily. The clients you choose should have been subject to large write-downs in the past, perhaps slow pay, maybe even with records in lousy shape.

If you have 100 or more clients and have not gone through client culling, it's a good bet you have at least 5 clients that fit that profile. You know the ones I mean; you probably have three of their names on the tip of your tongue. If you need to, prepare client evaluation forms to help you select your five. See exhibit 9-2, “Sample General Client Evaluation Form”; exhibit 9-3, “Sample Corporate Client Evaluation Form”; and exhibit 9-4, “Sample Tax Client Evaluation Form.”

Exhibit 9-2: Sample General Client Evaluation Form**Client Evaluation**

Client _____ Evaluator _____ Date _____

	1	2	3	3	5	Total
Value of services to the client			x			3
Development potential	x					1
Client cooperation			x			3
Economic stability			x			3
Timeliness of payment			x			3
Rating						13

- 1 = Excellent**
2 = Very Good
3 = Average
4 = Fair
5 = Poor

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Exhibit 9-3: Sample Corporate Client Evaluation Form

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Client Evaluation Questionnaire

Client _____

Account manager/partner _____

Date _____

(Circle only one number in each group.)

What is the usual condition of the client's records?

- 2 Unusable or always late
- 4 Scattered but workable
- 6 Client needs orientation
- 8 Good
- 10 Excellent

What is the total annual fee?

- 3 To \$1,500
- 6 \$1,500–\$5,000
- 9 \$5,000–\$10,000
- 12 Above \$10,000

What is the client's potential growth?

- 5 Terminating
- 10 Decreasing
- 15 Level
- 20 Growing
- 25 Unlimited

What is the client's attitude toward recommending us?

- 1 Would never do so
- 2 Might do so
- 12 Has not recently
- 16 Does at times
- 20 Does frequently

What is the client's attitude toward the IRS?

- 1 Apprehensive
- 2 Hostile
- 5 Apathetic
- 8 Cooperative

What does the client want from us?

- 1 Minimum service
- 2 Security regarding IRS
- 3 Counseling
- 4 Timely service
- 5 Direction and tax planning

What work do we do for the client?

- 3 Bookkeeping
- 6 Reviews or compilations
- 9 Audits
- 12 Year-end work and special services
- 15 Comprehensive services

From whom does the client seek information and advice?

- 1 Client's employees
- 2 News media
- 3 Client's competitors
- 4 Client's friends
- 5 Professionals (including us)

Does the client pay fees on time?

- 1 May never pay
- 2 Always 90 days late
- 5 Pays within 45 days
- 10 Pays when billed

How does the client react to fees?

- 1 Fees always challenged as too high
- 5 Requires itemized invoice
- 10 Usually accepts amount of invoice
- 15 Wants service and expects to pay
- 20 Thinks we are superior—pays premium

What is the client's attitude toward our staff?

- 1 Critical and argumentative
- 2 Uncooperative
- 3 Usually cooperative
- 4 Businesslike
- 5 Friendly and appreciative

What is the client's attitude toward expenses?

- 1 Spendthrift
- 2 Miserly
- 3 Economical
- 4 Liberal
- 5 Goes "first class"

Does the client expose us to legal action?

- 1 High risk
- 2 Would consider suit
- 3 Low risk
- 4 Little risk
- 5 Would never sue

What is the client's financial strength?

- 1 Insolvent
- 4 Solvent but undercapitalized
- 8 Adequate
- 10 Strong capital structure

Above conditions prevailed at month of _____

Evaluation by _____

Scoring:

Maximum = 154 points

Minimum = 23 points

30 points and below = Drop client

30–50 points = Evaluate in 90 days (on trial)

50–70 points = Make an attempt to upgrade client

70 points and above = Retain client

Total points _____

Make additional comments here:

Exhibit 9-4: Sample Tax Client Evaluation Form

Client: _____

Account Manager/Partner in Charge: _____

Evaluation by: _____

Date: _____

(Circle only one number in each group.)

Criteria and Relative Weight	Points	Description
1. Prestige (5 weight)	25	Community or business leader
	20	Attorney/banker
	15	Teacher—professional school
	10	Civic organization/other
	5	Friend
	0	Relative
2. Referrals—actual (6 weight)	30	Frequent and valuable
	24	Few and valuable
	18	Few and marginal
	12	None
	6	Few and worthless
	0	Frequent and worthless
3. Referrals—potential (1 weight)	5	Frequent and valuable
	4	Few and valuable
	3	Few and marginal
	2	None
	1	Few and worthless
	0	Frequent and worthless
4. Tie-in (2 weight)	10	Close relations to key clients
	8	Close relations to many clients
	6	Close relations to some clients
	4	Close relations to few clients
	2	Close relations to no clients
	0	Could cost us clients

Criteria and Relative Weight	Points	Description	
5. Fee range (9 weight)	45	Over \$15,000	
	36	\$5,000–\$15,000	
	27	\$2,500–\$5,000	
	18	\$1,000–\$2,500	
	9	\$500–\$1,000	
	0	Less than \$500	
6. Billing as a percent of standard rates (8 weight)	40	100% or more	
	32	95%–100%	
	24	90%–95%	
	16	80%–90%	
	8	75%–80%	
	0	Less than 75%	
		Individuals	Corporations
7. Cooperation—when does information come in (4 weight)	20	Before February 1	1/15
	16	Before March 1	1/31
	12	Before March 15	2/15
	8	Before March 31	2/28
	4	Before April 15	3/15
	0	After April 15	3/15
8. Information quality (3 weight)	15	All at once; neatly arranged	
	12	All at once; messy	
	9	Up to one-week delay for additional data	
	6	Up to two-week delay for additional data	
	3	More than two-week delay for additional data	
	0	Inadequate documentation	

(continued)

Criteria and Relative Weight	Points	Description
9. How long to pay invoice (7 weight)	35	By return mail
	28	15 days or fewer
	21	30 days or fewer
	14	45 days or fewer
	7	60 days or fewer
	0	More than 60 days
10. Value of services to client (10 weight)	50	Services only we can perform
	40	Services others can perform but we can do better
	30	Service other professionals can perform
	20	Services "anyone" can perform
	10	Services others can perform cheaply, faster, or better
	0	Services we are not competent to perform

Scoring	Make additional comments below:
Maximum score: 275	
Minimum score: 0	
275–240	Excellent
239–200	Very good
199–150	Good (attempt to upgrade)
149–80	Fair (evaluate in 90 days)
79–0	Poor (drop client)
Total points:	

- Mentally fire the clients. Make the emotional decision that these five people are no longer clients. They just don't know it yet. This frees you of a mental burden because now you don't have to decide whether to fire them. You can now decide whether to accept them as a new client in a new unit of time.
- Set up an appointment at the first client's office. Call the client and say, "Charlie, there's an important matter I need to discuss with you. Can we get together at your office?" Charlie Client may want to know what the meeting is about. If so, say:
 "I've been thinking about our relationship. There are a few things I am concerned with and it occurred to me that you might be a bit concerned about our relationship also. I'd like to come see you. Can we get together at your office?"
 Let's presume you have a real hard case:

Client: Well I don't want to see you because every time I talk to you, I have to pay for it.

Accountant: This meeting is on me, Charlie. There are some things we need to talk about. Can we get together at your office?

Client: Why can't we talk about it on the phone?

Accountant: I don't think our relationship is very good. I have some things that we need to discuss in person. Can we get together at your office?

Note that you end every scripted response with a question. The one who asks the questions controls the conversation.

4. At the meeting, review with the client your time-keeping and invoicing records for the last few years. This may be the first time Charlie has had a chance to see his fees from your viewpoint:

Accountant: Charlie, this year your engagement cost us \$9,000 and we charged you only \$7,000. Still, you complained and took 90 days to pay us. The year before, your job cost us \$7,950 and we charged you \$6,500 and you said we were too high. The year before that, you cost us \$6,000 and we charged you only \$5,000.

Think about it: most clients see only your invoice—they never see your time records and they have no idea whether you made money or lost money on their work. Remember the iceberg of time? Most of them think you make far more money than you do. Give your (former) client a chance to “walk a mile in your moccasins.”

5. Pause and give the client a chance to comment. If you're lucky, the client may say something like, “Gee, I didn't know that. I guess that means you're going to raise my fees a lot next year.”

Don't laugh; it has happened. Bravo! You now have a premium client in quadrant 1.

At least give the client a chance to respond. You may then discuss how much time it takes, how to reduce your costs, what services to eliminate, how to improve the client's cooperation to reduce your costs, and so forth. That can move them to “economy,” quadrant 2.

If that conversation does not produce a good result, or if the client says nothing, go on to the next step.

6. Say, “If you were me and you had a client like this, what would you do?” Then shut up, and wait for the client to respond. This is not a rhetorical question; you really want an answer. It may take 10 seconds or even 15 seconds for the client to respond, but wait it out.

Note that you have not told Charlie that he has been terminated. You have not burned any bridges, and you have not made the client wrong. You have merely given him some additional data about your relationship which he never knew, and you asked him his opinion. You have also encouraged him to look at the situation from an exterior, impersonal viewpoint by saying “a client like this,” not “a client like you.”

Clients who are good negotiators may take so long to answer that you will wonder whether they will ever speak. What's happened is that these clients realize that they've been caught. They got Cadillac service all these years for a Volkswagen price and they are feverishly trying to figure out what to say that will distract you so you will keep serving them for the same price. Eventually, they will respond.

At this point, the client has a number of options, as described in the following sections.

Client: Why tell me this now? I don't understand; you never had a problem with what I paid in the past. Why now?

This is the most embarrassing response of all. In effect, the client said, "What woke you up?" For many accountants, that's not the case at all.

So just respond to the client:

Accountant: It's only recently that we have become aware of this situation. In the past we have focused on giving you the best possible service. Frankly, we haven't paid much attention to what it cost to serve you. Recently, we made a detailed analysis of all our clients and discovered that you paid far less than our other clients.

Not only does this script work, it has the additional virtue of being true. Until you read this book and did the analysis, you had not focused on just how unprofitable some of your clients were. If you had, you would have done something about it sooner. Faced with this situation, the client may just submit to the inevitable, and say, "I guess this means I have to pay more next year."

In which case, you agree and you retain the client who is now profitable for you to serve. Bravo! Say something like this:

Accountant: That's right. And because of our friendship, I felt I needed to personally explain the situation to you. I didn't just want to send you a much larger invoice next year without explanation.

Congratulations! You now have accepted a new premium client who will be profitable to serve.

Here is a less desirable client response:

Client: You are inefficient and you should be able to do the work for less.

If your client is a tough negotiator, he or she may say something like that. Every business owner wants to get what he or she buys for the best price. That's the business owner's job. As business owners and even as savvy consumers, some clients will always object to your prices. That's what they do.

Of course you're not inefficient. Even if you were, the client has no way to know. It's just another negotiating ploy. Don't take this comment personally, take it professionally. This sort of approach is typical of an aggressive client. They don't mean it, it's just a smoke screen.

Don't get into a discussion of how efficient you are; you can't win. Instead, respond in the following way:

Accountant: Actually, we've been your accountant for four years now, and that's how long it takes.

Here is where your mental termination decision keeps you from caving in. You looked the client in the eye and—in a friendly but firm manner—you told him or her confidently that you have performed the job in a proper manner and that is what it costs.

And you might add:

Accountant: I have to make a living.

Then repeat the question, “If you were me and you had a client like this, what would you do?” Again, shut up, and make the client respond.

Client: But that isn't your cost; that standard rate includes a profit.

This aggressive response is a brazen, yet clever, attempt to exploit some accountants' guilt at the fact that they must make a profit or go out of business. Some accountants subconsciously downplay the fact that they make a good living (or at least try to).

Again, your response must be firm, confident, and unapologetic:

Accountant: Don't I deserve to make a living?

That might generate a discussion on the ethics of capitalism or some such philosophical talk, but most clients agree that you do deserve to make a profit.

Whether or not the client agrees you deserve to make a profit, continue with the following response:

Accountant: Charlie, if you take my profit, I can't stay in business to help you in the future. I have to make a profit just like you do. So the real question is, “If you were me and you had a client like this, what would you do?”

Do you see the trend here? You keep coming back to, “What would you do?” You are friendly, calm, patient, and persistent, very persistent.

Client: But you don't really expect to get 100 percent of standard.

That may be true, so you can also say:

Accountant: Yes, and I get an average of ____ percent on all my other clients. So, the question is, “If you were me and you had a client like this, what would you do?”

Again, remain silent for the client to respond.

Client: Your people falsify their time sheets; it doesn't take that long.

I have had only one CPA tell me he had a client so audacious that they tried this one. Don't get into an argument about your ethics or the honesty of your employees; the client doesn't mean this. It's just another negotiating tactic. Don't argue and defend your people. Just continue the conversation on your terms:

Accountant: Charlie, I know you don't really mean that because you would not want an accounting firm whose people you didn't trust. It really does take that long. So, the real question is, "If you were me and you had a client like this, what would you do?"

Client: I promise to work with you to reduce your costs to do my work.

Sometimes a sloppy client will reform, but don't hold your breath. You have a better chance if the client has a bookkeeper you can train. Naturally, you charge for training time. At least give him or her a chance. But make sure the client knows you will charge exactly what it costs at standard next time.

Client: Please, please, please! (Sniff.) Keep doing my work at a loss.

Some clients will beg for mercy. They will roll over, play dead, and hope you will take pity on them. "I just can't afford to pay any more!" or some such. If that is the case, refer them to an economy CPA firm or perhaps a bookkeeping service. Most likely, it's just another negotiating tool:

Accountant: Charlie, doing your work at a loss is not an option. I have to make a living just like you do. You can't continue to do business with customers you lose money on, and neither can I. So, the real question is, "If you were me and you had a client like this, what would you do?"

By this time, if the client has not agreed to pay more or work with you to reduce your costs, he or she is left with the final option.

Client: If I had a client like this, I would quit doing the work.

You have given the client several opportunities and hints to allow him or her to bring up the subject of reducing your costs or paying more. Your ideal scene is to make the client a premium one. Your fallback position is to make the client an economy client. At this point, the client has not volunteered to do either. Make a last-ditch try to convert the client to economy by saying:

Accountant: Charlie, I guess you're right. We always hate to lose a client, especially one who is a friend like you. But if we cannot either increase our price or figure a way to reduce our costs, that's what we'll have to do. [Pause again to see whether they want to take either option.] Because of our friendship, I wanted to discuss this situation with you personally. It is a business decision and not a personal one. Even though we won't be able to do business with you anymore, I want us to remain friends.

In any event, you part on good terms.

Most CPAs who do follow my *Cottle's Apple Pie* recipe report that more than two-thirds of their clients remain at substantially increased prices.

Handle the next four clients the same way. You'll be glad you did.

By the time you finish five clients, you might be surprised to learn just how valuable clients think you are and how much they will pay to access your expertise. Your self-confidence will soar.

Fire the Least Profitable Clients

If you had time available to talk to clients, and the team members available to do the work, how much VAS could you sell your current clients?

Imagine I could wave a magic wand and clone you, clone your fellow owners, and clone your employees. Your firm now has twice as many people and the same number of clients. In this imaginary world, you are no longer busy; you are no longer two weeks behind. In fact, you are looking for more work.

Now you have time to follow up with those clients who want to talk to you about their investments, their retirement plans, their strategic planning, their exit strategies, and their estate situation. You have the time to talk to them and—just as important—you have the people available to do the extra VAS work.

How much of this extra VAS work could you sell? Could you sell 20 percent, 50 percent, 70 percent? Many participants report they can sell between 20 percent and 70 percent more work to their current clients if they had the time to talk to them and the people to do the work.

Would this new work be at higher rates than your current average? Lower rates? The same rate? Most CPAs say that the new work would be at much higher rates, usually 25 percent to 50 percent higher than their current average.

Let's see what effect this could have on your profits.

Example: Suppose you charge 1,500 hours a year at \$225 an hour, net right now, yielding \$337,500. Even though the average rate is \$225 per hour, not all of those hours are of equal value; that's why you have write-downs. Let's suppose the worst 10 percent of your hours is worth only \$75 per hour, about what you would charge for an in-charge accountant.

If you terminate those 150 hours, you lose \$11,250 of revenue.

If you then resell those hours at just 20 percent more than your current average rate, you generate 150 hours times \$270 per hour, or \$40,500 of revenue.

You gain \$29,250 with no increase in costs. It all comes down to the bottom line.



Key Point: So fire 10 percent of your clients, and resell those hours at a higher rate.

Increase Your Minimum Individual Income Tax Price

Sort your individual clients from highest price to lowest price. Draw a line where the sales above the line account for 80 percent of your total individual tax revenue. If you do returns for minor children or other relatives, treat all members of the same family as one client. Set your minimum price at that amount for clients for whom you perform no other work. For many firms, that figure is about \$400 to \$500.

Immediately institute that number as your minimum price for new clients. Look at current clients whom you charge less to see whether to encourage them to go elsewhere or to purchase additional services from you—such as a year-end tax planning conference, estate planning, or investment advisory services—to get them above the minimum.

Remember the small firm I mentioned with 310 individual clients? The 134 largest individual clients accounting for 78 percent of the total 1040 revenue. The 176 smallest individual clients accounted for 22 percent.

If your firm is like that small firm, you could raise your minimum annual price for individual clients to \$400 or \$500. If you lost all clients who pay less than the new minimum, you would prepare less than half as many returns and the revenue loss would be immaterial. Plus, with more time to spend with remaining clients, you could probably enjoy an increase in other more valuable services such as estate and financial planning.

Raise Prices on Aggravating Clients to \$300 Above Standard

Life is too short to work with people that cause turmoil in your life or your practice. If you have clients that are a pain in the neck, next year charge them \$300 above standard. If they are a pain in the neck, at least make them pay for the privilege.

If they don't come back, you don't care. If they come back, consider raising them to \$400 over standard.

Give Your "Widows and Orphans" to Another Accountant

If you are like most accountants, you have accumulated your share of "widows and orphans" over the years. You probably took these on when you just started practice and were glad to get anything that you could. But your firm is bigger now and these clients are still hanging around. These small clients might be good clients for a new accountant just starting practice.

Chris Frederiksen, a California CPA, suggests a good way to get rid of these small clients without throwing them out into the cold—call a local practitioner who might want to take

these clients on and arrange to introduce these clients to him or her. Then, send a letter to your small clients notifying them of your new minimum prices and suggesting, “We have made arrangements with another accountant who will serve your needs for prices close to what you have been paying. Do you want us to arrange an introduction?”

Then, as Chris says, you have two people who love you—the old client and their new accountant.



Chapter 10

Avoid the Seven Causes of Unplanned Write-Downs

America's national pastime isn't baseball; it's watching the boss. Or, in the case of accounting firms, the owners.

Owners represent success to the employees, so employees study the owners' actions and emulate them. Whether the owners know it or not, they serve as examples for the employees to follow. The habits of the owners, good or bad, pervade the firm. If the owners conscientiously get their own time reports in on time, the employees will, too. If the owners invoice promptly, the employees will, too. If the owners are confident in their dealings with clients, the employees will be, too.

And vice versa. Many of the write-downs that accounting firms suffer stem, directly or indirectly, from the top. As you read this chapter, ask yourself, "What kind of message do I send the other people in the firm by my words and actions?"

Most unplanned write-downs result from one or a combination of only a few factors. This chapter defines write-downs and discusses seven principle causes behind them.

What Are Write-Downs, Really?

Write-downs are different from every other cost in one respect: they are a synthetic expense because they are not a necessary cost of doing business like rent or salaries. You could eliminate write-downs if you reduced chargeout rates to zero; then all invoicing would result in write-ups.

Revenue results from production (doing the work) and pricing (charging the proper amount). And net income is revenues, minus the costs of earning those revenues (cost management).

Accountants' opinions differ about whether write-downs are a function of pricing or cost management. Earlier I spoke about planned write-downs and unplanned write-downs. This chapter is concerned with unplanned write-downs, a function of cost management.

Cause 1: Estimating the Engagement Incorrectly


If you've ever visited a good restaurant Saturday at 8:00 p.m., you may have been told there is a 45-minute wait. Yet, if you looked at your watch, you may have noticed that you were seated in less than 45 minutes. The reason: better restaurants give the customer a better experience by conservatively estimating customer wait time. In other words, they lower the customers' expectations so the restaurant can beat its own estimated wait time.

We accountants should learn from their example.

If your construction clients estimated jobs the way most accountants do, they would go broke.

The typical PIC sends Sarah Supervisor to estimate a job because she has lots of experience with this client or this type of job. She comes back with an estimate of, say, \$12,650. "Sorry, Sarah," the owner says, "that's the wrong number. To keep this client happy, the correct number is \$10,000. Go back and try again."


So Sarah looks at her figures and thinks, "Maybe this year we won't have the inventory cutoff problems we've had on this client every year for the last three years. And maybe we won't have the overhead allocation problems we've had for the last three years. And maybe we won't have..." So she takes out all the margin for client errors that the firm has needed in the past. She returns with the \$10,000 budget but warns, "Boss, if we so much as have a power surge in the field and have to stop to reboot our computers, we can't make this budget."

 **Key Point:** Murphy's Law—If anything can go wrong, it will.

The PIC ignores Murphy's Law, puts on rose-colored glasses, and accepts the estimate, which he or she duly conveys to the client.

This creates the client's false expectations.

If optimism was measured on a scale of 1 to 10, the PIC has chosen to be a 12. Even as the words come out of his or her mouth, the PIC knows that making that budget is as likely as Greenland becoming a beach resort.

 **Key Point:** The PIC knows the firm will not make the optimistic budget, the supervisor knows it, but the client doesn't know it because the PIC misled them!

I can understand using a best-case, rose-colored glasses, optimistic budget to control the job and give the employees a target to shoot for. But if you give the client that same figure, it is like the restaurant host thinking, “If no one orders dessert, if no one has an extra cup of coffee, and if everyone pays cash, with correct change, then we can seat this customer in 25 minutes.” It ain’t gonna happen.

Key Point: Murphy’s Second Law—Murphy was an optimist. Everything takes longer than you think. Build a 20-percent pessimism quotient into all engagements.

If the client’s cutoff procedures for purchases, or shipping, or invoicing, or anything else have been lousy for the last several years, what makes you think they will be any better this year?

Yet, we kid ourselves and budget the job assuming everything will work well. As I said, optimistic budgets are okay to give employees something to shoot for. The problem arises if you use the optimistic budget to estimate the price for the client—or for ourselves!

Key Point: If you quote a price range, quote only the upper end of the range. If you quote the low end, the client will only remember the low end.

Even if you accept Sarah Supervisor’s first estimate and later analyze the actual time objectively to improve your estimating process, you learn nothing unless the data are accurate. Unfortunately, some accountants go through a rigorous process to prepare a time budget, and then neglect to post the actual time spent on the various components. Thus, they cannot compare actual to budget.

Exhibit 10-1, “Sample Client Time Budget,” is a form for budgeting time.

Exhibit 10-1: Sample Client Time Budget*

	Employee Budget			Actual	
	Initial	Hours	Amount	Hours	Amount
Fieldwork					
Assistant			\$		\$
Senior					
Team Leader					
Report Preparation and Review					
Assistant					
Senior					
Team Leader					
Partner					
Report Review					

(continued)

	Employee Budget			Actual	
	Initial	Hours	Amount	Hours	Amount
Quality Review					
Tax					
Tax Preparation					
Tax Review					
Administrative					
Other					
Total					

ENGAGEMENT LETTER

Quote: \$ _____ to \$ _____ Prepared by: _____

Date: _____

Approved by: _____ Date: _____

*Rita Keller, President, Keller Advisors, LLC. www.ritakeller.com.

The time budget does no good until you compare it to actual. Many accountants fail to keep systematic records to track the results of their budget process. The only number they know for sure is the total hours spent by each person. But those data are available from the time-keeping system and do not enable the accountant to evaluate the performance of the team members who worked on the engagement. Treat each line item of the time budget as a contract between the firm and the personnel who are to perform that part of the engagement. If they go over budget, hold them accountable. But you have to know the actual time spent on each section.

Exhibit 10-2, "Sample Cost-Effective Service and Work Codes," illustrates one way to use cost-effective service codes for client cost accounting and invoicing. You can use the same codes to accumulate actual time within your management information system.

Exhibit 10-2: Sample Cost-Effective Service and Work Codes

	Bookkeeping and Compilation	Financial Statements		Tax			Financial Planning	Management Consulting	Litigation Support
		Reviewed	Audited	Individual	Business	Planning			
Planning, Develop Program	001	101	201	301	401	501	601	701	801
Research	002	102	202	302	402	502	602	702	802
Supervision and Review	003	103	203	303	403	503	603	703	803
Team Conferences	004	104	204	304	404	504	604	704	804
Client Meetings, Interviews	005	105	205	305	405	505	605	705	805
Telephone Conference	006	106	206	306	406	506	606	706	806
Correspondence or email	007	107	207	307	407	507	607	707	807
Clerical, Keyboarding, and so on	008	108	208	308	408	508	608	708	808
Travel	009	109	209	309	409	509	609	709	809
New Client Setup	010	110	210	310	410	510	610	710	810
Interim Write-up and Data Entry	011								811
Year-End Write-up	012								
Year-End Adjustments	013	113	213						
Manual Check Preparation	014			314	414	514	614		
Lead Schedules	015	115	215						815
Document Accounting System		116	216					716	816
Test Internal Controls			217						
Cash and Bank Reconciliation	020	120	220	320	420	520	620	720	820

(continued)

	Bookkeeping and Compilation	Financial Statements		Tax			Financial Planning	Management Consulting	Litigation Support
		Reviewed	Audited	Individual	Business	Planning			
Other Current Assets	021	121	221						821
Accounts Receivable and Allowances	022	122	222						822
Notes Receivable	023	123	223						823
Inventory	024	124	224						824
Property, Plant, and Equipment	025	125	225						825
Depreciation and Depreciation Schedules	026	126	226	326	426	526	626	726	826
Other Assets and Amortization Schedules	027	127	227	327	427	527	627	727	827
Accounts Payable	028	128	228	328	428	528	628	728	828
Unrecorded Liabilities, Other Accruals		129	229	329	429	529	629	729	829
Income Taxes	030	130	230	330	430	530	630	730	830
Long-Term Debt	031	131	231				631		831
Other Liabilities	032	132	232						832
Equity	033	133	233						833
Retained Earnings	034	134	234						834
Commitments and Contingencies		135	235						835
Sales and Revenues		136	236						836
Payroll and Employee Benefits	037	137	237						837

	Bookkeeping and Compilation	Financial Statements		Tax			Financial Planning	Management Consulting	Litigation Support
		Reviewed	Audited	Individual	Business	Planning			
Calculate Paycheck and Payroll Tax Deposit	038								
Analytical Review		139	239						839
Financial Statement Preparation, Report Writing	040	140	240			540	640	740	840
Review of Prior Periods	041	141	241	341	441	541	641		841
Footnotes, Disclosures	042	142	242						842
Tax Credits	043	143	243	343	443	543	643		843
Tax Carryovers	044	144	244	344	444	544	644		844
Estimated Tax	045	145	245	345	445	545	645		
Income Tax Preparation				350	450				
Trust Return Preparation					451				
Amended Returns				352	452				852
Multiple State Returns				353	453				853
Computer Charge	054	154	254	354	454	554	654	754	854
Tax Audit				355	455				
Estate Tax Preparation				356					856
Partnership Tax Preparation					457				857
Pension Plan Return					458				858
Payroll Report Preparation	059			359	459				859
Sales Tax Returns	060			360	460				860

(continued)

	Bookkeeping and Compilation	Financial Statements		Tax			Financial Planning	Management Consulting	Litigation Support
		Reviewed	Audited	Individual	Business	Planning			
Worker's Compensation Reports					461				861
Prepare K-1s, 1099s, and 1098s					462				
SS-4, Other ID Requests	063			363	463		663		
W2, W3 Preparation	064			364	464				
Extensions	065			365	465				
Tax Projections, Estimated Taxes				366	466	566	666		866
Liquidation Planning						567			867
Financial Plan Analysis							669		869
Business Valuation								770	870
Purchase Investigation								771	
Loan Negotiations								772	
Budget, Forecast, Projection								773	873
Money-Saving Ideas	074	174	274	374	474	574	674	774	
Resolve IRS and State Tax Issues	075			375	475				
Buy-Sell Agreements						575	675	775	875
Rework (Firm Error)	088	188	288	388	488	588	688	788	888
Rework (Client Error)	089	189	289	389	489	589	689	789	889
Chargeable Extras	090	190	290	390	490	590	690	790	890
Administration and Collections	091	191	291	391	491	591	691	791	891
Other	095	195	295	395	495	595	695	795	895

Consider the following typical problems you run into:

- Bank accounts not reconciled
- Receivables out of balance
- Account codes inconsistent or just wrong
- Transaction volume much higher than you thought
- Large turnover in the accounting department

When do you learn about these things? Before you begin the work or after?

The time to handle difficult matters is before they become difficult.

Is there ever a time when these types of problems are easy?


Yes, when you first learn of them.

We've all heard the horror stories of huge write-downs from apparently inescapable circumstances that led to the disaster. But think back: Was that fiasco necessary? Was there anything the accountant could have done earlier in the engagement that might have avoided, or at least reduced, the write-down?


The answer is usually, "Of course, if I had just had time to do the budget, or review the condition of the records, or look at the volume of transactions, or... or... or...."

We all have the same 24 hours each day, so, "If I had just had the time," means, "If I had just taken the time."


The correct actions that would have prevented disaster always could have and should have been taken earlier in the engagement, before things got out of hand.

 **Key Point:** An ounce of planning is worth a pound of performance (to paraphrase Ben Franklin).

And I might add the following:

 **Key Point:** An ounce of communication ahead of time is worth a pound of finger-pointing after the fact.

I learned a hard lesson from my own practice back in the 1970s: It's better to learn the client has a severe cash-flow problem before you run up \$10,000 of WIP on the audit. And 35 years ago, \$10,000 was a lot of money.

 **Key Point:** The best time to discover problems is when your negotiating position is better than the client's. That is before you start work. After the firm's time has been expended (and is, of course, 100-percent perishable), the client has the upper hand.

You want to find out about the problems while the client is still hurting and needs what you have to offer. After the engagement is complete, after the client's problem has been solved, you may have to come and beg for your money.

The key issue is, when do the people who must resolve the problem first learn about it?

Example: One of my client CPA firms had audited a nonprofit organization for the previous three years. (This was in 1996.) Fees ran \$2,500 to \$2,950 each year. The firm quoted a price for the fourth year of \$2,950. The client was not as well prepared as in the past and the in-charge did substantial work to get the records in shape to audit. Standard fees ran over \$4,000. The firm lost money. The owner in charge of this small job was not aware of the overrun until he reviewed the file in the office—after the horse was out of the barn!

Key Point: The in-charge learned of the problem when he was in the field, but he never told the owner.

The ideal is that the supervisor becomes aware of problems soon after the staff person does, and the PIC should learn of the problem soon after that.

If the client only learns of the problem weeks later, perhaps because the invoice is larger than he expected, then serious trouble will be created in client relations.

Cause 2: Not Specifying What Is Included in the Price Estimate and What Is Not

Accountants often quote a client a retainer or fixed price for an engagement. If they do not specify what the engagement includes and—more importantly—does not include, they can get sucked in to doing more and more work each month without charging for the extras.

This is the “scope creep” mentioned earlier.

One way to avoid this unpleasant situation is to hold two planning conferences—one with the client and one with the staff who will work the engagement.

Client Planning Conference

The client planning conference has several objectives, which include the following:

- Set clear boundaries to the engagement.
- Control the client's expectations.
- Ensure the client's commitment to provide assistance to keep your costs down.
- Ensure the client's willingness to pay your invoice.
- Ensure that the client pays for all extra work.

The client planning conference ensures that clients understand the following:

- What work your firm will do, which is contemplated in the price estimate or time budget

- What work is excluded or will be charged extra (with special emphasis on items you did last time that you now want the client to do, or items included in the price last time that are not included now)
- What the client's employees' responsibilities are for the successful completion of the engagement (Include schedules and analysis to be prepared by clients, documentation to be gathered by them, and so forth.)
- How you will determine the price
- When the client will pay

Exhibit 10-3, "Sample Client Planning Conference Form," is a form to document the planning conference with the client.

Exhibit 10-3: Sample Client Planning Conference Form

Date: _____

Client representative: _____

CPA firm representative: _____

The purpose of this planning conference is to ensure agreement on the following items:

What work is contemplated in the fee estimate or time budget? (Special emphasis on items: (1) that we did last time that we now want the client to do; (2) that were included in the fee last time that are not included now; and (3) other differences this year.)

What work is specifically excluded, or will cost extra?

Client personnel responsibilities for the successful completion of the engagement

Client personnel name:

Responsibility:

How we will determine the fee:

Payment terms:

Team Planning Conference

The objective of your team planning conference is to avoid scope creep. How? The conference ensures that firm team members do work only covered by the price estimate, and that the client authorizes and pays for any extra work your team members undertake. The planning conference ensures that employees understand the following:

- What work the price estimate or time budget covers
- What work is excluded, or will be charged extra—this helps avoid scope creep by putting your team on notice.
- What each employee's responsibilities are for the successful completion of the engagement (and that specifically includes the responsibilities of the client's employees)
- How you will determine the price

Exhibit 10-4, "Sample Staff Planning Conference Form," is a form to document the employee planning conference.

Exhibit 10-4: Sample Staff Planning Conference Form

Date: _____

Persons present _____

The purpose of this planning conference is to ensure agreement on the following items:

What work is contemplated in the fee estimate or time budget? (Special emphasis on items: (1) that we did last time that we now want the client to do; (2) That were included in the fee last time that are not included now; and (3) other differences this year.)

What work is specifically excluded, or will cost extra?

Team member responsibilities for the successful completion of the engagement

Team member:	Responsibility:	Time budget:
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

How we will determine the fee:

Payment terms:

Cause 3: Inefficiency (Sometimes Laid at the Feet of the Employee's Supervisor)

Time is an investment. If you or your team works on a client's account, you invest time. From this activity, clients require a return and so also does the firm.

Consider this: every hour a person works has a cost to the firm regardless of whether the person is an owner or an employee, regardless of whether the time is chargeable or nonchargeable. You might think of work time (whether chargeable or nonchargeable) as investment time. Your people either invest it on behalf of a client (chargeable time) or on behalf of the firm.

Here are a few ways to get more efficient:

- Repeal Parkinson's Law: One reason employees spend so much time on engagements is Parkinson's Law, which states the following:
 - Work expands to fill the time available for its completion.
 - If you give an employee an assignment without a time budget, he or she now has a new career. You must give the employee a time budget on every assignment—then, hold the employee accountable for meeting it.
- Work in the field whenever possible: Many smaller clients have no room on their premises for you or your employees to work. Yet, even in a small CPA firm, 20 percent to 25 percent of the work that you and your employees do could be done in the field. In the field, you work more efficiently because you work straight through without interruption. For instance, if an employee needs information, he or she will find it easily in the field. In the office, the employee often sends an email or leaves a message for the client and puts the file away to work on another engagement. This *put-away time* and *start-up time* drains efficiency.
- Stay in the field longer: *Fieldwork* pays off for both owners and employees. Do as much of your file review in the field as possible. It makes the iceberg of time visible to the client and creates opportunities for more client interaction—always a good thing.
- Exclude PIC time from the budget: Your employees cannot control PIC time. Putting it on the budget merely distracts them.
- Do the job backwards: Draft the financial statements first. Then, see what work you have to do to support those assertions. You may find that if you “worked your way down the balance sheet” without considering the assertions, you would have wasted valuable time on immaterial or insignificant items.
- Post time backwards: Have you ever noticed how efficient you are the day before you leave on vacation? You must finish everything that day, and somehow you get it all done. This is the “Friday-before-vacation” phenomenon. Put this phenomenon to work in your favor by showing an “hours-remaining-in-budget” balance. The in-charge sees a decreasing amount of time and the “Friday-before-vacation” phenomenon takes over; everything gets done more efficiently.

- Post time to the time budget daily: Have your in-charge accountant review each person's posted time daily and compare it to budget.
- Go to the field to do your review: Every week, go out on a larger job.
- Have a "chargeable extra" work code under audits, reviews, compilation, taxes, and any other categories of work: One reason you do not invoice certain chargeable extras is that you do not find out about them because the employees have no place to post the time. See exhibit 10-2 for sample cost-effective service codes, and note code 090, "Chargeable Extras."
- Pay employees at least partially based on how well they meet budget: Allocate unplanned write-downs on jobs to individuals who work the job, based on how well they met their budgets for the segments they worked on.

Follow several of these suggestions and the work proceeds more efficiently.

Cause 4: Bad Scheduling

Bad scheduling can take two forms—assigning an inappropriate person for the job and wall-to-wall scheduling.

Assign the Right Person to the Job

Assigning an overqualified person to work below his or her capabilities is bad scheduling. This uses high-priced talent to do low-value work and incurs unneeded costs. Assigning an under-qualified person can also be bad scheduling. People who are in over their heads may spin their wheels, waste time, and consult with superiors far more often than more qualified staff would.

Peter Drucker points out that people who get little done often work a great deal harder. There are three main reasons for this:

1. They underestimate the time required for any task. They ignore Murphy's Law and assume everything will go right. Yet nothing ever goes exactly right. The unexpected always happens. Indeed, the unexpected is the one thing you can confidently expect. Therefore, allow a fair margin of time beyond what you think you will need.
2. They try to hurry and that puts them further behind. Remember the old saying: "The hurrieder I go, the behinder I get."
3. They try to do several things at once. They never have the minimum time block needed for any of the tasks on their agenda. If any task runs into trouble, the entire agenda collapses.

Avoid Wall-to-Wall Scheduling

This principle of scheduling a large enough block of time to complete a task also applies when scheduling assistants, particularly in-charge accountants. Too often, an owner will estimate 10 more days of fieldwork for job "Alpha" and thus will schedule the in-charge

to begin job “Bravo” in 11 days. This does not allow the in-charge time to wrap up job “Alpha” back in the office. As a result, job “Alpha” languishes on the in-charge’s desk, 90 percent complete. Set priorities with your employee, because he or she may have information that you do not have.

Don’t schedule yourself (or anyone) wall-to-wall. Scheduling owners about 70 percent of their available time allows time for the unexpected events which always seem to demand an owner’s time each day.

Note that wall-to-wall scheduling can cause client price resistance because of the delay that occurs between the end of fieldwork and the delivery of the finished product. The client sees that your employees “finished” because they are no longer in the field. So, the client expects the finished product in a few days. If it does not arrive, the client is disappointed or jumps to the conclusion that you are inefficient.

Moreover, wall-to-wall scheduling can cause of this kind of delay. Most assignments cannot be completed in the field. Employees need to review, write the report, and research. Booking them on their next assignment before they have time to complete the last one has several bad effects:

- You have incurred up to 90 percent of your costs but have nothing to show the client.
- Your working capital is tied up in a job many owners hesitate to invoice. (Yet another reason to do interim invoices.)
- The client must wait for the expected benefit.
- Your employees feel hassled and pressured.
- The work gets “cold” and when employees finally return to finish, they must spend time reacquainting themselves with the details.
- If it is necessary to ask the client questions from the review, the firm looks bad because of the delay.

The cure—stay in the field as long as possible; do as much work in the field you can; and allow employees an appropriate amount of office time at the completion of fieldwork to finish the job.

Cause 5: Bad Supervision

Too often, accountants hide bad supervision by blaming their employees (“That employee should have done that job in 12 hours!”) or bad scheduling (“If I had the right person available for that assignment, we could have made budget!”). Those circumstances occur, but not as often as we pretend.

Supervision is a complex issue that involves planning, budgeting, and monitoring.

Plan

Owners too often tackle an engagement with no planning. Remember the expression, “Ready... fire...aim”? PICs have done so many financial statements, or audits, or consolidated tax returns, or what-have-you, that they view any time spent planning the engagement as wasted. That may be true for small, routine engagements they perform themselves.

However, the situation becomes more complicated when they use employees.

Employees do not have an owner's years of experience and may approach an engagement differently.

Example: Imagine you drive from Houston to Austin and back every week. You know which exit to take off I-10, which state highway cuts 45 miles off the journey, and which alternate route across the cities of Houston and Austin usually has the least traffic, depending on the time of day. You do not need to consult a map; you know how to do it.

But suppose you decide to delegate that trip to an employee who has never made the drive. You might think, “She knows how to drive. If she gets in trouble, she can use her GPS, or look at a map, or just ask me.” The GPS does not show how much traffic she can expect on each route; only your experience tells you. And the employee may hesitate to ask questions because she does not want to appear ignorant.

Investing a few minutes of instruction in the shortcuts can take an hour off the drive. It is no different for professional engagements.

Budget

People hit a target better if they can see it. The most basic budget is simply to tell the assistant how much time you expect the job to take. Do not expect the employee to look up how much time the tax return, or whatever, took last year. In the first place, last year's circumstances may have been different. In the second place, people do not do what you expect, they do what you inspect. If the employee thought like an owner all the time, you would pay him or her like an owner. You owe it to your employees and yourself to give them a budget on every assignment.

Monitor

A mission to Mars is off-course 90 percent of the time. Without “mid-course corrections,” the mission would miss Mars by millions of miles.

A firm's assignments are similar; they need “mid-course corrections.” Giving an employee an 80-hour assignment and then waiting two weeks to check on them is wishful thinking. When I was an audit partner, one of my large audits grew from 200 hours to 1,000 hours over a period of years. I never missed the time budget by more than two percent. I visited the field weekly and reviewed the work, conferred with the audit manager, and then met with the client to report on the status and make any needed revisions to the budget and schedule.

Cause 6: Inadequate Skill in Managing the Client Relationship

The supervisor or PIC doesn't receive adequate client cooperation in assisting with the job.

Many accountants undertake engagements based on price estimates to which they agree with the client. Often, these engagements appear routine when you estimate the price. Perhaps the firm has done this engagement for several years and with no significant problems. Or you have done engagements for other clients who resemble the new client. You base your price estimate on assumptions about the conditions you will face in performing the service. One assumption is the degree of client cooperation or client preparedness (or both). Sometimes you discover the bad news after the engagement has begun—the client does not cooperate or is not prepared. In such cases, the job takes longer and costs run higher than estimated.

Example: Remember my client firm that audited a nonprofit for three years with fees of \$2,500 to \$2,950? The firm quoted the fourth year at \$2,950. The in-charge did substantial work to get the records in shape to audit and standard charges ran over \$4,000. The PIC learned about the overrun when he reviewed the file in the office—after the audit was complete. The PIC told me, “The in-charge should have told me when he found the client's books in bad shape.” Whose fault was it? The in-charge or the PIC? Does it matter? The PIC must take responsibility to ensure the employees know what to do and what not to do.

The client planning conference and team planning conference can prevent this problem.

Too often, CPAs assume that client personnel will analyze accounts, investigate confirmation exceptions, pull customer or vendor files, and prepare worksheets. In many cases, that is wishful thinking. The client's employees' responsibilities continue even if the outside CPAs are there. Without clear agreements about the client's personnel assistance, it does not always happen. That is why the two planning conferences are so important.

Cause 7: Unwillingness to Confront the Client

The seventh cause of unplanned write-downs is an unwillingness to confront the client on important issues. Unnecessary write-downs qualify as an “important issue.”

Many accountants will do anything to avoid conflict. They are almost terrified at the thought of losing a client. They will take a large write-down—even a write-off—in preference to confronting a client.

As I mentioned earlier, accountants often hide bad estimating, bad supervision, bad client management, or lack of courage by blaming their write-downs on inefficiency or bad scheduling. In reality, those circumstances do not occur as often as we pretend. Ron Weiner has stated, “If the job has gone over budget three years in a row, or if you have lost money on the last three engagements of this type, it is time to rethink the pricing.”

This issue is closely related to “inadequate skill in managing the client relationship.” Why? Accountants who do not know how to manage their clients often wind up unable to confront them on important issues.

I discussed the importance of having two planning conferences—one with the client and one with your employees.

Without a planning conference, the accountant sometimes feels guilty for overruns—even those caused by client personnel who were derelict in their accounting duties. The guilt makes the accountant avoid confronting the client with bad news until the engagement is over—or the accountant may never tell the client about engagement problems. Then you wind up with the “bashful biller” situation I discussed earlier.

If the accountant does tell the client about the extras, the client may or may not pay. A client caught off guard will be at least miffed and possibly angry enough to take future business elsewhere. A nasty client loss makes accountant gun-shy, and he or she may react to this kind of engagement problem by turning away from it—that is, by avoiding the client. This dwindling spiral of loss of self-confidence causes many accountants to absorb losses rather than deliver bad news and risk losing the client.

Remember, clients will appreciate you more as a business adviser if you run your own practice in a businesslike manner. That is why I remind you to play the offense, not the defense. As soon as you know or can anticipate a problem, take the initiative to call the client. The planning conferences give you the basis on which to communicate with the client. Think of these communications as progress reports.


But what do you do if you did not have a planning conference?

That makes your situation tougher, but you still have a chance. The sooner you act, the better. Lock the barn door before the horse gets out. If a client's records are in bad shape, discuss this with the client before you do more work. As you explain the situation, make your words a reminder that this is the client's problem, not yours. Say, “Your bank accounts have not been reconciled for the last six months.” Then ask, “What do you intend to do about it?” Because it is the client's problem, it is the client's responsibility. The client may wish to engage you for an extra fee to fix the situation, but it is not part of the original engagement or the original price estimate. That is when you discuss a change order.


Chapter 11

How to Set the Right Standard Chargeout Rates

One widespread misconception in most accountants' thinking is that setting prices is a mathematical process based on analyses of overhead costs, salaries, competitors' charges, and so forth.

 **Key Point:** Setting prices is a marketing decision.

The dollar amount the time-keeping system produces influences the amount you invoice the client because of the anchor effect, introduced in chapter 8, “How to Discuss Prices With Clients.” So, most accountants assume the time-keeping system indicates approximately the amount they should charge. This is not true. The amounts used in your time-keeping system are a management decision. You could cut those rates in half, or double them, and they would not change the value of the service to clients.

 **Key Point:** Setting standard chargeout rates is a management decision.

So do not confuse the prices you charge clients with the standard rates in your time-keeping system. Standard rates measure standard revenue, or *opportunity cost* to perform the work. They measure, if you will, the effort the firm invested in an engagement; they do not measure the value of that engagement to the client.

You cannot offer a service that costs you more to provide than clients will pay. For example, you are technically capable of washing your client's windows. But if your cost of employees is more than the going rate for window washers, you cannot offer that service profitably.

Key Point: The principal (and often overlooked) purpose of standard chargeout rates is to determine the profitability of serving each client. Second, using the discipline of standard rates allows the firm to determine the profit contribution of each PIC's ledger. Third, using standard rates allows the firm to determine the revenue contribution of each time-keeper.

Standard chargeout rates also represent an *opportunity cost* to the extent you work on clients who value your services less than other clients and who will not or cannot pay as high a percentage of standard fees as other clients.

Your goal should be for all your people to work at their highest professional level for clients who appreciate and can afford that level of service. You may attain that ideal level of performance only 10 percent of the time; your employees may attain it only 30 percent to 40 percent. But that is the goal. If you achieve the goal, for most of you, that deserves a chargeout rate considerably higher than the one you currently use.

Ask yourself, "What chargeout rate do I deserve if I practice at my *ideal scene* (the top 10 percent of your capabilities)?"

After all, this is the ideal scene, and you do not achieve that very often. But the reason most people do not achieve their goals is that they don't have any. When you keep the goal in sight, it is easier to attain.

For this purpose, think of your chargeout rates as the amount of value you could deliver to clients if you and all the people of your firm worked at their highest professional level, on valuable services, for clients that appreciate and can afford that level of service. Think of it as an *opportunity cost accounting system* that measures the degree to which you do not achieve your ideal.

Imagine a CPA who charges 1,500 hours per year and generates revenues of \$375,000 for an average effective rate of \$250 per hour. Let's call her Alicia Accountant. Not all of Alicia's hours were worth \$250. In fact few were; the majority of her hours were worth more or less than \$250, but she averaged \$250 for the year.


Further imagine that you could sort all 1,500 of Alicia's hours by value from top to bottom. Add them all up and they total \$375,000. If you count down from the top and total the top 10 percent (150 hours) of Alicia's hours, how much do you think each hour is worth on average? Most of my participants say, about 30 percent to 40 percent above average—say, \$325 to \$350 per hour.


Now imagine you can count up from the bottom and total the bottom 10 percent of Alicia's hours. How much do you think these bottom 150 hours were worth, on average? Most participants say between 50 percent and 70 percent of average, say \$125 to \$175 per hour.

If you looked at the type of work Alicia Accountant did for her "top 10 percent" hours, you would find a preponderance of tax planning, business advice, and other value-added

services (VAS). Likewise, her bottom hours are spent on bookkeeping, payroll taxes, compilations, reviews, and possibly audits.

If Alicia does a good job for her bookkeeping clients, but the market won't bear her standard rates, it makes no sense to kid ourselves by assigning a higher standard than she can ever achieve. Likewise, the market for tax advice and other VAS is always strong, and using the same standard rates for these services as for bookkeeping gives her no target to stretch for, so she undercharges for VAS services.

 **Key Point:** Because your efforts have different values, your standard chargeout rates should differ also.

 **Key Point:** For most clients, I recommend that they set tax and VAS rates 25 percent higher than accounting and auditing and other compliance service rates.

Why the Two-Percent Rule Is Dead

Many firms use two percent of average monthly compensation as their standard chargeout rate per hour. See eMAP section 202.03—Standard Billing Rates and Pricing.

The two-percent formula was derived from the rule that firms should get revenue from employees of three times their compensation. The old precept was “one-third salary, one-third overhead, and one-third profit.”

Example: Section 202.03 uses an individual with total annual compensation of \$45,000 (\$40,000 + \$5,000 overtime and bonus) and a standard rate of \$75. If the employee works 1,800 chargeable hours, the annual standard revenue is \$135,000.

That is three times the annual compensation.

If the firm also invoices 100 percent of standard fees, direct labor is 33 percent of revenues (\$135,000 of revenues divided by \$45,000 of salary). The two-percent rule has been around since at least the 1960s. But is it still appropriate?

The rule is based on three assumptions:

1. 1,800 chargeable hours
2. Overhead equals salary cost
3. 100 percent realization

Today, with increased requirements for technical education, time off, and management and marketing time, it is almost impossible to yield 1,800 chargeable hours without significant overtime and even with overtime it is a challenge to achieve. In fact, Profile firm E's technical employees get from 1,419 to 1,506.

According to the eMAP Exhibit 503-4 Financial Information, the 2,362 firms responding to the 2012 PCPS/TSCPA National Management of an Accounting Practice Survey, experienced average write-downs of 13.6 percent.

As a result, few firms get anywhere near a three times multiple on their salary costs.

Example: One client, before I began working with them, had a staff accountant with a base annual salary of \$41,600, a \$66 chargeout rate, 1,664 expected chargeable hours, and 94-percent realization.

Chargeout rate per hour	\$ 66
Chargeable hours	<u>× 1,664</u>
Gross fees	\$109,824
Realization	<u>× 94%</u>
Net sales	\$103,235
Divided by salary	<u>\$ 41,600</u>
Actual chargeout multiple	2.48

What multiple of salaries does your firm generate?

Exhibit 11-1, "Profile Firm Annual Chargeout Multiple," calculates the profile firm's chargeout multiple with a column to calculate your multiple. You might be surprised.

Exhibit 11-1: Profile Firm Annual Chargeout Multiple

	Profile Firm	Your Firm
Net sales (standard fees from exhibit 2-3, "Profile Firm Analysis of Revenue" [chapter 2] × realization*)		
Technical employees (\$1,748,650 × 90.5%)	1,582,528	
Owners (\$602,000 × 90.5%)	544,810	
Total direct personnel	2,127,338	
Salaries		
Technical employees (from exhibit 2-1, "Profile Firm Income Statement" [chapter 2])	636,000	
Owners (from exhibit 2-6, "Profile Firm Fair-Market Value of Owners' Salaries" [chapter 2])	324,359	
Total direct personnel	960,359	
Annual chargeout multiple (Net sales divided by salaries)		
Technical employees	2.49	
Owners	1.68	
Total direct personnel	2.22	

*Realization = 90.50% (Write-downs from exhibit 2-3, "Sample Profile Firm Analysis of Revenue" [chapter 2])

Total *net sales* differs from net sales on the income statement because I excluded support personnel. You won't get a three-times multiple for support personnel. Including them in the total personnel multiple would distort the number by making it even lower.

Firms that use inadequate standard chargeout rates earn inadequate profits. If your standard rates are inadequate, adopt a new formula. But what formula is appropriate?

There are many ways to capture your opportunity costs in a new formula.

Three-Step Formula for Setting Standard Chargeout Rates

Here is one approach to set appropriate standard chargeout rates:

1. Determine your overhead and direct salaries (include owners' salaries). Use exhibit 11-2, "Profile Firm Overhead," to calculate your firm's overhead. Note that, to the extent you do not charge clients for support employee services, those support salaries are overhead for the technical personnel.

This number differs from the analysis in exhibit 2-11, "Profile Firm Overhead Analysis," because exhibit 2-11 included all support salaries in overhead. The analysis presented in exhibit 11-2 reduces overhead by net sales produced by support personnel.

2. Determine an appropriate *markup* on your direct salaries and overhead. In other words, decide how much revenue you should generate with your current cost structure. Most accountants agree that the "one-third profit" part of the two-percent rule is a realistic target. That means you can view the target markup as 50-percent markup on the sum of direct salaries and overhead. Working with that assumption, exhibit 11-3, "Profile Firm Target Markup," calculates the target markup and net sales for the profile firm's targets with a column for you to calculate your own firm's target.
3. Increase standard rates across the board to achieve your targets for direct personnel. Exhibit 11-4, "Profile Firm Standard Chargeout Rate Needed," calculates the average standard rate increase necessary for the profile firm and your firm.



Key Point: Typically, the average owner rate in a normally structured firm would be three to four times the rate of a new professional employee.

Exhibit 11-2: Profile Firm Overhead

Line	Overhead	Profile Firm	Your Firm
1	Salaries, Support Employees (from exhibit 2-1, "Profile Firm Income Statement" [chapter 2])	108,500	
2	Less, Net Sales Generated by Support Employees (from exhibit 2-3, "Profile Firm Analysis of Revenue" [chapter 2] times realization) ($\$42,500 \times 90.5\%$)	38,462	
3	[Line 1] – [Line 2] in Net Salaries, Support Employees	70,038	
4	Other Costs and Expenses (All Generally Accepted Accounting Principles Expenses Plus Interest on Accrual-Basis Capital):		
5	Imputed Interest on Owners' Capital	54,000	
6	Consultation, Unallocated	16,000	
7	Data Processing, Unallocated	43,300	
8	Personnel	157,000	
9	Facilities	173,000	
10	Marketing	41,000	
11	Other Operating Expenses	113,000	
12	Nonoperating Expenses	27,000	
13	[Sum of Lines 3 through 12] in Total Overhead Costs	694,338	
	Direct Salaries		
14	Owners	324,359	
15	Technical Employees	636,000	
16	Paraprofessional Employees	—	
17	[Sum of Lines 14 through 16] in Total Direct Salaries	960,359	
18	[Line 13] ÷ [Line 17] in Overhead rate as percent of direct salaries	72.30%	

Exhibit 11-3: Profile Firm Target Markup

Line		Profile Firm	Your Firm
1	Direct Employee Salaries	\$ 636,000	
2	Overhead (Line 18 of exhibit 11-2 times Line 1 of this table)	459,827	
3	[Line 1] + [Line 2] in Total Direct Costs	\$1,095,827	
4	Times Markup Percentage	50.00%	
5	[Line 3] × [Line 4] in Target Markup	\$ 547,913	
6	[Line 3] + [Line 5] in Targeted Net Sales From Direct Employees	\$1,643,740	
7	Divided by Realization	90.50%	
8	[Line 6] ÷ [Line 7] in Targeted Standard Fees From Direct Employees	\$1,816,288	

Exhibit 11-4: Profile Firm Standard Chargeout Rate Needed

		Profile Firm	Your Firm
1	Targeted Standard Fees From Direct Employees (Line 8 of exhibit 11-3)	1,816,288	
2	Direct Personnel Chargeable Hours (from exhibit 2-3, "Profile Firm Analysis of Revenue" [chapter 2])		
3	Technical employees	22,950	
4	Paraprofessional employees	0	
5	[Line 3] + [Line 4] Total	22,950	
6	[Line 1] ÷ [Line 5] Required Average Chargeout Rate per Direct Person	\$ 79.14	
7	Current Average Chargeout Rate per Direct Employee (from exhibit 2-3, "Profile Firm Analysis of Revenue" [chapter 2])	\$ 76.19	
8	[Line 6] ÷ [Line 7] – 1.00 Increase Necessary	3.87%	



Chapter 12

Motivating Your People to Bill What They Are Worth

The typical accounting firm invoicing system includes many of these characteristics:

- Owners do the invoicing, or at least approve all invoices before clients see them.
- They invoice based on standard charges plus some out-of-pocket expenses.
- They send invoices after the engagement is finished—sometimes long after.
- Progress invoices are sent only after the engagement is well begun and much of the cost is incurred.
- The entire invoice often is sent only after the engagement is complete.
- Clients don't know the price of the engagement in advance. But, they nevertheless have some idea of what the price "should" be.
- Even though the firm completes an engagement in the early part of the month, the invoice goes out after the first of the following month—again, sometimes long after.
- Time reports are supposed to be input daily, but they are frequently late—especially from the owners.
- WIP reports are delayed several days after the end of the accounting period.
- Some owners don't invoice on the first day the WIP is available.

Do any of these characteristics look familiar? The more of them you have in your firm, the more profitability trouble you will have.

There are steps you can take to encourage more effective pricing. These steps include the following:

- Define chargeable and nonchargeable time.
- Use the 50-minute hour.
- Daily time reporting
- Round up, not down
- Use peer pressure.
- Require a second owner to approve substandard invoices.
- Invoicing promptly to avoid “Toxic Lockup”
- Invoice progressively.
- Let employees draft invoices.
- Do not compromise on prices.

Each of these techniques is discussed in the following sections.

Define Chargeable and Nonchargeable Time

Firms often encounter a problem with owners and employees who give away the firm's services to clients by not recording all their chargeable time—in effect donating such services to clients.

Over 30 years ago, Stephen Weinstein of Siskin, Shapiro & Company in Hartford, Connecticut, noticed that certain employees and owners had lower chargeable time than normal.¹ Discussion disclosed differences of opinion among various owners and employees as to the definitions of chargeable time and nonchargeable time. Firm personnel charged time inconsistently.

My consulting experience shows this holds true at most CPA firms.

Example: An entry-level employee at one firm charged only seven hours in an eight-hour day. She explained to me that she figured that coffee breaks, visits to the restroom, conversations in the hallway, and so on were “nonchargeable” time that amounted to an hour a day.

Example: An owner in a two-owner firm told me he did not charge clients for time spent at lunch. He also confided that he did not charge clients for telephone calls. It was no surprise to me when he also admitted that certain clients had discovered this practice and were now taking advantage of his generosity. His fellow owner, on the other hand, charged all such time, and their differences were a constant irritation. The two partners eventually broke up.

If you investigated, you might discover that many of your employees do not understand the nature and importance of accurate time-keeping procedures. Further, you might

¹ Stephen Weinstein, CPA, “Survey on Chargeable Time,” *The Journal of Accountancy*, August 1982, pp. 87–90.

discover that some of your fellow owners work under different philosophies of how to charge time and how much time to charge.

Key Point: Less-experienced employees tend to undercharge. Similarly, owners who believe that the firm has set their chargeout rates too high will tend to under-report their time.

As Weinstein observed, “Their approach could best be described as, ‘When in doubt, show the time in one of the nonchargeable categories’” The particular problem areas include the following:

- Business-related lunches with clients: Some people have problems differentiating between the social and business aspects of client lunches. They also have difficulty deciding whether to charge for the time depending on whether the client paid for lunch. This is ironic because the person’s hourly chargeout rate may be 10 times the cost of the lunch. Similarly, they have difficulty determining whether to charge the client’s WIP for the expense of the lunch if the accountant pays for the lunch.
- Business-related dinners or other after-hours activities with clients: The same considerations as business lunches exist, plus the complication of whether spouses accompany the CPA and client.
- Time spent researching a client problem: Some accountants, both owners and employees, rationalize not recording research time because they think they should have known the answer to the problem they were researching. Alternatively, they assume the knowledge gained will also benefit other clients, therefore they do not charge it to the client first benefitted. As a result, they under-report their time.
- Evaluating their own productivity: Similarly, some accountants view their normal performance as super-heroic. They evaluate their own performance and often find it wanting. So they don’t record all their time.
- Interruptions at work: Problems often occur in one department with accountants being interrupted with questions by personnel from other departments. Owners, too, are interrupted by employees with routine questions regarding clients for whom the owner is responsible and on whom the employee is working. Often, the higher-level people will not keep track of these interruptions. They accumulate a lot of time that was spent on clients but which is shown as nonchargeable.

Practice Tip—The cure for this: before responding to any question, your people should be required to ask which client should be charged for the answer.

- Travel time: Particular problems are travel from one client to another, travel outside normal office hours, and travel outside your normal market area.

Practical Tips: Adapt exhibit 12-1 to your own firm, and ask your employees and owners to complete it. You might be surprised at the answers. Use the tabulation of results as the agenda for a firm meeting.

Exhibit 12-1, "Sample Time-Recording Survey," is an illustrative questionnaire and Exhibit 12-2, "Sample Results From Time-Keeping Survey," is the actual results of a questionnaire used on an assignment for a 70-person Midwestern CPA firm. The firm selected a random sample of 20 people from all personnel levels.

Exhibit 12-1: Sample Time-Recording Survey*

Instructions

This survey is intended to determine the time recording practices used by various people in the firm. Please consider each question carefully. We want to know how you actually record your time. Please don't answer what you think we want to hear; tell us what you would really do in the situation described.

For each question, indicate how you would charge the time described. Please complete this form and return it by _____.

We will soon update our policy manual on time reporting based on this survey. As part of this project, we will establish clear guidelines for accounting for time.

Name _____ Department _____

Years of public accounting experience _____

Years with our firm _____

	Not Record the Time	Report the Time As:	
		Non- Chargeable Number of Hours	Chargeable Number of Hours
1. During a regular workday at the client's office, you and the controller go to lunch. The lunch takes 1.5 hours. Most of the discussion related to the client's business.			
2. Same as (1), but the lunch takes 1 hour.			
3. Same as (1), but the lunch takes 2 hours.			
4. The president of one of our clients asks you to dinner to discuss an accounting, tax, or business problem. The dinner takes 2 hours. Most of the discussion relates to the client's problem.			
5. You are working at a client's office and encounter a technical question which takes 20 minutes of research to answer.			
6. Same as (5), except you are working at our office.			
7. Same as (5), except that you feel the research involved an area of practice you should have known.			
8. Same as (5), except that you feel the research you did would have taken the "average" person (that is, one not as knowledgeable as you) 1 hour to accomplish			
9. Same as (5), except the research took you 1 hour, you do not feel competent in this type of research, and you believe that it should have taken you about 20 minutes.			

(continued)

	Not Record the Time	Report the Time As:	
		Non-Chargeable Number of Hours	Chargeable Number of Hours
10. You are working in our office on client X. Another team member interrupts you to ask questions about a problem he or she is having on client Y (for whom you have no responsibility). The interruption lasts 20 minutes. Select only one of the following, and indicate how much time would you charge to:			
Client X			
Client Y			
Neither			
11. Same facts as (10), except the interruption lasts 10 minutes. How much time would you charge to (check an option):			
Client X			
Client Y			
Neither			
12. During the day, you do not feel well and believe that your productivity was about 1 hour less than it should been due to coughing spells, blowing your nose, trips to the bathroom, and so on. You have worked on one client for the entire day, and the time lost due to illness is about 1 hour.			
13. Same facts as (12), except that you have worked on 4 different clients during the day.			
14. During a typical workday at the client's office, you determine that, counting trips to the coffee machine, bathroom, and water cooler and a personal phone call, you had about 15 minutes of nonclient personal time. How do you report those 15 minutes?			
15. Same facts as (14), except you were working in our office all day on 1 client.			

	Not Record the Time	Report the Time As:	
		Non-Chargeable Number of Hours	Chargeable Number of Hours
16. Same facts as (14), except you were working in our office all day on several different clients.			
17. You are under severe time pressure on an assignment. You do not want to go over budget. So on one day, you bring some work home and spend 1 hour completing it.			
18. Same as (17), except you do this on several days (that is, 1 hour a day at home.)			
19. Same as (17), except you work several hours on one night (most of the night) to complete a job due the next day.			
20. While working in your office, another person comes over to talk to you on a nonclient matter. He or she leaves 15 minutes later.			
21. A client decides to close the office an hour early on Friday. At that point, you have spent 7 chargeable hours at the client's office. It's too late to come back to our office so you go home, where you work one hour to finish the day. For this last hour...			
22. During the day at the client's office, a client's employee gets into a conversation about some nonclient matter (that is, a personal problem or sports). The conversation lasts 15 minutes. For that 15 minutes...			
23. Same as (21), except the conversation lasted 25 minutes.			
24. A client telephones or emails you for some advice. You give the answer, which is helpful to the client. The call or email takes 2 minutes.			
25. Same as (24), except the call or email takes 10 minutes.			

(continued)

	Not Record the Time	Report the Time As:	
		Non-Chargeable Number of Hours	Chargeable Number of Hours
26. Same as (24), except the call or email takes 20 minutes.			
27. A client telephones, texts, or emails you to arrange an appointment with you. The call, text, or email response takes 2 minutes.			
28. Over a period of 2 weeks, the same client calls or emails you 4 times for advice. Each time you give the client a helpful answer. Each call or email takes only a few minutes.			
29. Your normal travel time to our office is 30 minutes. You leave your house 15 minutes early because it takes you 45 minutes to travel to a client's office. You stay there all day. Regarding the excess 30 minutes of travel...			
30. In the morning you travel to client X. After lunch you travel to client Y, which takes 30 minutes. Regarding this 30 minute trip from client X to client Y, how much time would you charge to (check an option):			
Client X			
Client Y			
Neither			
31. You encounter a sophisticated technical question you previously researched for another client. The original research took 3 hours. Photocopying this research data for the second client takes 5 minutes. How much time would you charge the second client?			
32. On a new engagement you take last year's file home to review at night, which takes you 2 hours.			
33. Same as (32), except you review the file in our office the day before you are to begin work at the client's office.			

	Not Record the Time	Report the Time As:	
		Non-Chargeable Number of Hours	Chargeable Number of Hours
34. You have a technical question concerning a client. During lunch, you discuss it with another team member who gives you the answer, saving you about an hour of research.			
35. You spend 10 hours doing a schedule. Later, you discover you made a major mistake. It takes you 3 hours to redo the schedule. Regarding the 3 hours of correction time.			

*This exhibit is adapted from the article entitled "Survey on Chargeable Time," by Stephen Weinstein, *Journal of Accountancy*, August 1982, pp. 87–90.

Use the 50-Minute Hour

Exhibit 12-2 "Sample Results from Time-Keeping Survey" confirms that some accountants are quite literal when it comes to charging time; they adopt a "stopwatch" approach to time keeping. They think that if they don't have their hands on the keyboard, concentrating on the client, then the time isn't chargeable. This tendency seems prevalent at firms that charge in tenths of an hour rather than quarter-hours. The tenth-of-an-hour increment engenders an attitude of exactitude that does not reflect the realities of professional practice.

Exhibit 12-2: Sample Result From Time-Keeping Survey

1. During a regular workday at the client's office, you and the controller go to lunch. The lunch takes 1.5 hours. Most of the discussion is about the client's business.
 - a. Charged one-half hour: 13
 - b. Charged 3/4 hour: 1
 - c. Charged one hour: 2
 - d. Charged more than one hour (that is, the actual time spent): 3
 - e. Charged more than one hour (but less than the actual time spent): 1
2. The same facts as item 1, but the lunch takes one hour.
 - a. Not shown on the time sheet: 13
 - b. Charged 1/2 hour: 2
 - c. Charged 3/4 hour: 1
 - d. Charged one hour: 4
3. The same facts as item 1, but the lunch takes two hours.
 - a. Charged one hour: 16
 - b. Charged more than one hour (that is, the actual time spent): 3
 - c. Charged more than one hour (but less than the actual time spent): 2

4. The president of one of our clients asks you to dinner to discuss an accounting, tax, or business problem. The dinner takes two hours. Most of the discussion is about the client's problem.
 - a. Shown on the time sheet as "nonchargeable": 1
 - b. Not shown anywhere on the time sheet: 2
 - c. Charged one hour: 1
 - d. Charged more than one hour (the actual time spent): 12
 - e. Charged more than one hour (but less than the actual time spent): 4
5. You are working at a client's office and encounter a technical question, which takes 20 minutes of research to answer.
 - a. Shown on the time sheet as "nonchargeable": 4
 - b. Charged 1/4 hour: 11
 - c. Charged 1/2 hour: 5
6. The same facts as item 5, except you are working at our office.
 - a. Not asked on survey
7. The same facts as item 5, except that you feel the research involved an area of practice you should have known.
 - a. Shown on the time sheet as "nonchargeable": 8
 - b. Not shown anywhere on the time sheet: 3
 - c. Charged 1/4 hour: 6
 - d. Charged 1/2 hour: 2
8. The same facts as item 5, except that you feel the research you did would have taken an average person (that is, one not as knowledgeable as you) one hour to accomplish.
 - a. Shown on the time sheet as "nonchargeable": 4
 - b. Charged 1/4 hour: 9
 - c. Charged 1/2 hour: 6
 - d. Charged one hour: 1
9. The same facts as item 5, except the research took you one hour, you do not feel competent in this type of research, and you believe that it should have taken you about 20 minutes.
 - a. Shown on the time sheet as "nonchargeable": 4
 - b. Not shown anywhere on the time sheet: 1
 - c. Charged 1/4 hour: 5
 - d. Charged 1/2 hour: 5
 - e. Charged one hour: 5
10. You are working in the firm's office on client X. A team member interrupts you to ask questions about a problem he or she is having with client Y (for whom you have no responsibility). The interruption lasts 20 minutes. Select only one of the following and indicate how much time you would charge: Client X 1, Client Y 15, Neither 4?
 - a. Shown on the time sheet as "nonchargeable": 4
 - b. Not shown anywhere on the time sheet: 1
 - c. Charged 1/4 hour: 11
 - d. Charged 1/2 hour: 4
11. The same facts as item 10, except the interruption lasts 10 minutes. Select only one of the following and indicate how much time you would charge: Client X 1, Client Y 12, Neither 6?
 - a. Shown on the time sheet as "nonchargeable": 8
 - b. Not shown anywhere on the time sheet: 1
 - c. Charged 1/4 hour: 11

12. During the day, you do not feel well and believe your productivity was less than it should have been as a result of coughing spells, blowing your nose, trips to the bathroom, and so on. You have worked on one client for the entire day, and the time lost due to illness was about one hour.
 - a. Shown on the time sheet as “nonchargeable”: 13
 - b. Not shown anywhere on the time sheet: 2
 - c. Charged one hour: 5
13. Not asked on survey.
14. During a typical workday at the client’s office, you determine that you made trips to the coffee machine, bathroom, and water cooler, and placed a personal phone call, totaling about 15 minutes of nonclient personal time.
 - a. Shown on the time sheet as “nonchargeable”: 6
 - b. Not shown anywhere on the time sheet: 2
 - c. Charged 1/4 hour: 12
15. The same facts as item 14, except you were working in your office all day on one client.
 - a. Shown on the time sheet as “nonchargeable”: 9
 - b. Not shown anywhere on the time sheet: 3
 - c. Charged 1/4 hour: 8
16. The same facts as item 14, except you were working in your office all day on several different clients.
 - a. Shown on the time sheet as “nonchargeable”: 12
 - b. Not shown anywhere on the time sheet: 3
 - c. Charged 1/4 hour: 5
17. You are under heavy time pressure on an assignment. You do not want to go over budget. So, on one day, you bring some work home and spend one hour completing it.
 - a. Shown on the time sheet as “nonchargeable”: 1
 - b. Not shown anywhere on the time sheet: 5
 - c. Charged 1 hour: 14
18. The same facts as item 17, except you take work home on several days—that is, one hour a day at home.
 - a. Not shown on the time sheet: 3
 - b. Charged 1/2 hour: 1
 - c. Charged 1 hour: 6
 - d. Charged more than one hour (that is, the actual time spent): 8
 - e. Charged more than one hour (but less than the actual time spent): 2
19. The same facts as item 17, except you work several hours on one night (most of the night) to complete a job due the next day.
 - a. Not shown on the time sheet: 3
 - b. Charged more than one hour (that is, the actual time spent): 14
 - c. Charged more than one hour (but less than the actual time spent): 3
20. While working in your office, another person comes over to talk to you on a nonclient matter. He or she leaves 15 minutes later.
 - a. Shown on the time sheet as “nonchargeable”: 14
 - b. Not shown anywhere on the time sheet: 5
 - c. Charged 1/4 hour: 1
21. A client decides to close his or her office an hour early on Friday. At that point, you have spent seven chargeable hours at the client’s office. It’s too late to return to the firm’s office, so you go home, where you work for one hour to finish the day.
 - a. Shown on the time sheet as “nonchargeable”: 6
 - b. Not shown anywhere on the time sheet: 10
 - c. Charged one hour: 3
 - d. One person would charge time needed to drive home.

22. During the day at a client's office, a client's employee gets into a 15-minute conversation about a nonclient matter (that is, a personal problem or sports). The conversation lasts 15 minutes.
 - a. Shown on the time sheet as "nonchargeable": 2
 - b. Not shown anywhere on the time sheet: 2
 - c. Charged 1/4 hour: 16
23. The same facts as item 22, except the conversation lasted 25 minutes.
 - a. Shown on the time sheet as "nonchargeable": 2
 - b. Not shown anywhere on the time sheet: 3
 - c. Charged 1/4 hour: 2
 - d. Charged 1/2 hour: 13
24. A client telephones or e-mails you for some advice. You give the answer, which is helpful to the client. The call or e-mail takes two minutes.
 - a. Shown on the time sheet as "nonchargeable": 8
 - b. Not shown anywhere on the time sheet: 4
 - c. Charged 1/4 hour: 2
 - d. Charged 1/2 hour: 1
 - e. Four persons would charge 1/10 hour.
25. Not asked on survey.
26. Not asked on survey.
27. A client telephones, texts, or e-mails to arrange an appointment with you. The call, text, or e-mail response takes two minutes.
 - a. Shown on the time sheet as "nonchargeable": 12
 - b. Not shown anywhere on the time sheet: 6
 - c. Charged 1/4 hour: 2
28. Over a period of two weeks, the same client calls or e-mails four times for advice. Each time, you give a helpful answer. Each call or e-mail takes only a few minutes.
 - a. Shown on the time sheet as "nonchargeable": 4
 - b. Not shown anywhere on the time sheet: 1
 - c. Charged 1/4 hour: 10
 - d. Charged 1/2 hour: 1
 - e. Three persons would charge 1/10 hour.
29. Your normal travel time to our office is 30 minutes. You leave your home 15 minutes early because it takes 45 minutes to travel to a client's office. You stay there all day. The excess travel time totals 30 minutes.
 - a. Shown on the time sheet as "nonchargeable": 2
 - b. Not shown anywhere on the time sheet: 4
 - c. Charged 1/4 hour: 2
 - d. Charged 1/2 hour: 12
 - e. Charged 3/4 hour: 1
30. In the morning, you travel to client X. After lunch, you travel to client Y, which takes 30 minutes. Select only one of the following, and indicate how much time you would charge. Client X 3, Client Y 11, Neither 1?
 - a. Six would split it between the two clients, charging 1/4 hour to each.
 - b. Shown on the time sheet as "nonchargeable": 1
 - c. Not shown anywhere on the time sheet: 3
 - d. Charged 1/4 hour: 16

31. You encounter a sophisticated technical question you previously researched for another client. The original research took three hours. Photocopying this research data for the second client takes five minutes. How much time would you charge the second client?
 - a. Not shown on the time sheet: 1
 - b. Charged 1/4 hour: 8
 - c. Charged 1/2 hour: 2
 - d. Charged one hour: 3
 - e. Charged more than one hour (that is, the actual time spent): 6
32. For a new engagement, you take last year's working papers home to review them at night, which takes you two hours.
 - a. Shown on the time sheet as "nonchargeable": 5
 - b. Not shown anywhere on the time sheet: 2
 - c. Charged one hour: 2
 - d. Charged more than one hour (the actual time spent): 11
 - e. Charge more than one hour (but less than the actual time spent): 1
33. Not asked on survey.
34. You have a technical question concerning a client. During lunch, you discuss it with another team member who gives you the answer, saving you about one hour of research.
 - a. Shown on the time sheet as "nonchargeable": 2
 - b. Not shown anywhere on the time sheet: 15
 - c. Charge one hour: 3
35. You spend 10 hours doing a spreadsheet. Later, you discover you made a major mistake. It takes you three hours to redo the spreadsheet. Indicate how you would charge the three hours of correction time.
 - a. Shown on the time sheet as "nonchargeable": 7
 - b. Not shown anywhere on the time sheet: 3
 - c. Charged one hour: 1
 - d. Charge more than one hour (that is, the actual time spent): 7
 - e. Charge more than one hour (but less than the actual time spent): 2

Also, some accountants think of themselves as machines that should not have normal human needs for refreshment, visits to the bathroom, and brief social interactions with co-workers.

In one interview, I asked an employee how he determined how much time to charge. He proudly displayed his digital wristwatch with a built-in stopwatch. "When I start to work on a client, I punch the stopwatch button. When I finish, I punch it again, and it tells me exactly how long I've worked on that client." If he then got a cup of coffee or went to the bathroom between clients, he would not start his stopwatch until he picked up the file for the next client.

Another employee in the same firm said, "I never have eight hours chargeable, even if I'm busy all day. I always put at least three-tenths of an hour to [a nonchargeable category]." Others in the firm had similar stories. As a result, all employees ended each day with between three-tenths of an hour and 1.1 hours unaccounted-for, which they plugged to a nonchargeable category. No wonder it was dubbed the "stopwatch firm."

Key Point: Personal interviews and reviews of actual time records show that some people have a policy of charging at least one hour a day to such unspecified nonchargeable activities, even if occupied all day long on chargeable engagements!

In fact, the AICPA recognizes 50 *contact minutes* (minutes in a classroom) as one hour of continuing professional education credit. Universities have 50-minute classes, for which students get one hour of credit. Marriage counselors and other consultants use 50-minute counseling sessions for their hourly rate. And most firms set their chargeout rates on the (unstated) assumption that the eight-hour workday will generate eight chargeable hours. They just don't explain that to the employees and all the owners.

A short break or a brief conversation with a coworker doesn't make the time nonchargeable. If a person is productively occupied for at least 50 minutes of the hour, they should charge one hour. The 50-minute hour allows you to capture more chargeable time that is not getting invoiced.

Practice Tip—Adopt the “50-minute hour” as the firm's time-keeping philosophy. Hold an “all hands” meeting to explain to firm personnel that your firm already allows for normal human physical and social needs when you set chargeout rates. The firm expects personnel to have normal breaks in their work routine each day. Therefore, if they are otherwise productively occupied the entire day, the firm expects personnel to record eight hours to chargeable categories.

Occasionally, using the 50-minute hour causes a person to end the day with more than eight hours recorded. This happens most often to people who handle many files each day (such as support personnel or technical quality reviewers) and who charge a minimum of one-quarter hour to each file.

Key Point: It is okay to charge more than eight hours in an eight-hour day. After all, sometimes you charge less than eight hours if you have worked on clients all day, don't you? Report the excess as a negative amount in a non-chargeable code so your total hours worked is accurate.

Think of your time-keeping practices as “presenting fairly” how you spend the firm's resources.

Adopt Daily Time Reporting

Even if you stop donating time to clients and adopt the 50-minute hour, you could still be losing productivity because of the fallibility of human memory and misunderstandings about firm policy. Because over 90 percent of all firms report time daily, there is no need to belabor the point. Nevertheless, some firms still allow their people to wait until the following day to input their time.

Many people are careless about recording their time as they go. If time is typically reported and reviewed by management the following morning, some people will wait until that morning to input their time. Then they try to remember what they did the previous day. Faulty human memory, along with the tendency to resolve all doubt in favor of the client, mean that some chargeable time gets lost.

Also, if time records are prepared the following morning, accountants tend to charge a minimum of one-quarter to one-half hour to a nonchargeable code for the time spent entering their time. If time records are done at the end of each day and recorded before leaving for the day, no time is charged to a nonchargeable code for time reporting.

Practice Tip—Have all employees in the office input their time before they leave at the end of the day—not first thing the next morning, but before they leave for the day. Those working out of the office can report using remote computer access before shutting down for the day. Then have the firm administrator review all time records for accuracy and conformance to firm policy. If the firm administrator sees time charged to a nonchargeable category by an employee who should be 100 percent chargeable, the administrator should immediately question the employee. Frequently, the employee will have spent the time working on a client, but will have made a unilateral decision not to charge the time.

Example: I recommended that the “stopwatch firm” described earlier adopt both daily time reporting and the 50-minute hour. I followed up three months later and learned that their utilization had increased 19.9 percent.

Round Up, Not Down

When I speak on pricing, I often ask participants, “How many of you invoice to the penny? That is, if the WIP says \$1,782.50, you will invoice \$1,782.50.” Invariably between 95 percent and 100 percent of participants over the years indicate that they do not invoice the amount on their WIP. Instead, they round to an even amount.

Then I ask, “Imagine you have an engagement for a small corporate tax return. They have been a client for several years. The WIP was \$1,782.50. How much would you invoice, assuming it was a routine engagement that ran into no problems and the WIP amount was the same as last year?” The participants give answers that are posted on a flip chart. Answers normally run from a low of \$1,600 to a high of \$1,900, with most answers falling in the \$1,700 to \$1,800 range.

Most participants round down, and most of them would round \$1,782.50 down to \$1,700 or \$1,750. A minority of participants round up and most of them would round up to no more than \$1,800.

Then, I point out that, in this case, the difference between rounding up and rounding down is \$100, less than six percent. If you were to charge \$2,000, your client might have a question about the amount. If you were to charge \$1,500, your fellow owners might have a

question or two. But what about the difference between \$1,700 and \$1,800? I ask, “Do you think it matters to your client whether your charge is \$1,700 or \$1,800?”

Most everyone agrees that small differences are insignificant to clients. But the typical owner sends out several hundred invoices each year.

Key Point: Round up all invoices over \$1,000 to the next \$100. Round up all invoices between \$500 and \$949 to the next \$50. Round up invoices less than \$474 to the next \$25.

What would be the effect if each of those were rounded up instead of down? The answer may be as many as 500 invoices a year times \$50 or \$100, or \$25,000 to \$50,000 a year for each owner.

Use Peer Pressure

You can increase realization simply by getting your owners to invoice more. It sounds simple, and it is. But simple does not always mean easy.

One Michigan firm realized only 70 percent of standard when I began working with them. And their rates were not high; in fact, I had them raise owner rates. They also developed a list of what they called “underachievers”—specific clients who yielded less than 75-percent realization. They circulated the list to all owners each month and owners began to take pride in getting clients for whom they were responsible off the list.

This increased profits \$350,000 in four months. The simple expedient of passing out each owner's numbers each month allowed peer pressure to do the rest.

As realization rose, they increased the underachiever threshold to 80 percent and then 85 percent.

Require Second-Owner Approval on Substandard Invoices

I showed a Utah firm how to get owners to invoice more with no increase in new business, no change in costs, no improvement in efficiency. Using this simple procedure, they began to charge more for the same work and increased their realization from 87 percent to 95 percent in less than a year.

Here is how they did it: The firm's owners had always invoiced “in a vacuum.” PICs (who were all owners) did not confer with each other on how much to invoice. Each month they distributed the WIP for each client to the PIC for each client. Each PIC then drafted invoices. They were typed, reviewed by the same PIC, and mailed.

The owners agreed to require that any invoice with a write-down of more than five percent be approved by the managing owner (who happened to be a bold biller), or at least by some second owner. This allowed the managing owner to discuss the value of the work

with the invoicing owner and thereby lead them to see the value of the work. The managing owner also gave the other billers a little courage, as needed, to confront clients who were low in profitability.

The firm went one better—they began to observe “Invoicing Monday.” The first Monday of each month, they brought sandwiches into a conference room, and all 10 owners met over lunch to do their invoicing. And they didn’t leave until it was finished.

Invoice Promptly to Avoid “Toxic Lockup”

“Toxic lockup”—like the “toxic assets” of many financial institutions—are amounts in WIP that have little or no value. My colleague Mark Lloydbottom pointed out that when lockup of a UK accounting firm exceeds 32 percent of annual revenues, the excess has little or no value. In the United States, I would use 25 percent.

Key Point: Lockup which exceeds 25 percent of annual sales is worth much less than its book value.

There are five reasons a firm needs to invoice promptly, and they are described in the following sections:

1. WIP Depreciates

Accountants are good at figuring depreciation. They can tell a client that computer equipment depreciates 33 percent a year. How fast does the value of WIP depreciate? The *value* is, “what clients are willing to pay for the service they have just received.”


Key Point: The value of a service rendered declines rapidly once the service is completed.

If you wait 30 days to invoice your client, the value he or she perceives may have declined by 10 percent, 20 percent, or more.

Key Point: Once an invoice or WIP gets 90 days old, it becomes “toxic lock-up”—practically worthless.

That is why I recommend *event invoicing*—sending an invoice to a client after every significant service event.

Example: Say you send a tax return to the client on the 4th of the month or their financial statements on the 10th of the month. Why wait until the first of the following month to send the invoice?

 **Key Point:** Your invoice should arrive in the client's hands while the tears of appreciation are still wet on their cheeks.

2. Clients Want to Know What They Owe

People get nervous when they owe money, but they don't know how much. You do them a disservice when you delay the inevitable.

Example: I once lost a client because I delayed sending her invoice. She was a freelance writer. I sent her the tax return. She called to thank me and asked where the invoice was.

I told her, "Don't worry about it, I will send it soon."

A couple of weeks later she called about the invoice again. "I have money now," she explained. "My business is 'feast and famine,' and I am trying to pay all my bills while I have the money. If you wait much longer to send my invoice, I may not have the money to pay you."

Still I delayed. I sent her the invoice a couple of weeks later. She sent me a check and a thank you note by return mail, but she never came back.

She was distressed at the idea of owing money when she had the money to pay. She liked to be out of debt, and I made that impossible by not sending her invoice.

3. You Get Paid More Quickly

This is so obvious that most people—even CPAs—overlook it. The sooner you invoice, the sooner they pay you. It's better to have the money in your bank than in theirs. This reduces bad debts.

4. Clients Remember What You Did

Even if you prepare detailed invoices, you seldom list all the services you performed. And even if you do, the invoice alone is insufficient to remind clients of the good feelings they got from your good service.

Send the invoice while clients can still remember how good they felt when you helped them.

5. You Can Remember What You Did

No matter how detailed your service codes, your time-keeping system will seldom capture everything you did for a client: the telephone consultations, the late-night calls, the office conferences, the memos you sent, the special reports you prepared.

Invoicing while these events are fresh in your mind helps you write a more complete, descriptive invoice.


Invoice Progressively

There are five reasons to send progress invoices:

1. Allowing WIP to Build Up Intimidates the CPA and Increases Write-Downs


It's emotionally easier to send a client an \$800 invoice than a \$1,800 invoice. And it's easier to send two \$6,000 invoices than one for \$12,000.

If you wait, the WIP builds and builds. After two or three months (or even after two or three weeks), the balance may get so large that the number itself intimidates you. This makes you write down the price even if you don't need to.

 **Key Point:** Progress invoice at the end of each month to keep the WIP balance at a number that is easier for you to confront.

2. Clients Would Rather Pay Five \$1,000 Invoices Than One \$4,000 Invoice

Just as it is emotionally easier for you to send a small invoice, it is easier for a client to pay several small invoices than one large one.

 **Key Point:** Make the arrival of your invoices a regular occurrence in clients' mail, not a remarkable event.

3. The Larger an Invoice Is, the More Difficult for Clients to Pay

There is a reason that automobile companies encourage buyers to lease or finance their cars. It's financially easier to make a series of small payments instead of one large one.

Learn from their example. Clients find it easier to write a small check. Make it easy for clients to pay you.

4. Invoices Over a Certain Size May Require a Second Signature to Pay

The treasurer may have to get a second signature for checks over \$5,000 or \$10,000. It's one more chance for someone to complain about your invoice, and it's just one more delay in getting paid.

5. A Large Invoice at the End of an Engagement Invites the Client to Try to Renegotiate the Price

Waiting to send a large invoice after you have finished a long engagement tempts some clients to reopen price negotiations. Remember that after you finish the work, you have little leverage. Invoicing as you go—while more work remains—gives you the leverage to stop work.

As the client pays, he or she implicitly accepts your prices and waives the right to reopen the discussion.

So break your invoices into smaller chunks.

Let Employees Draft Invoices

Let employees draft invoices for routine or mandatory services. PICs should approve all invoices before sending them out. Letting employees do the invoicing has four advantages:

1. It Is Good Training for Future Promotions

Someday, your employees may be PICs. Even if they never become owners, at least they should learn to handle smaller clients as PIC.

Invoicing is an important part of serving a client. Let your employees practice invoicing under your supervision.

2. Employees Will More Likely Remember Extra Services They Did

Often, clients authorize extra service during the regular engagement. Sometimes, these extras do not get documented in the engagement letter or by a change order. Often, they are too small to bother with. Occasionally, a client may contract directly with an in-charge for extra work.

Letting the in-charge prepare the invoice gives him or her a chance to charge for the extra work that you don't know about.

3. Employees Often Have More Courage Than the PICs

It seems strange that employees have the courage to invoice more than the owners because they have little financial stake in the amount of the invoice. Yet, some owners are predisposed to take write-downs (the "bashful billers") and no amount of peer pressure or financial penalties changes their behavior.

For these owners, let their employees prepare the invoices. Because the employee has little financial stake in the amount of the price, he or she is more objective about the value of the engagement and is not distracted by other factors. Because of the anchor effect, even a bashful biller is less likely to reduce an invoice once it is already prepared.

4. It Makes Employees More Cost-Conscious and More Efficient

If an employee knows that he or she is going to have to invoice the engagements they work on, this knowledge stimulates them to be more efficient and to document any extra work.

Do Not Compromise on Prices

When I had been in practice about four months, I got my first significant client, a real estate developer who had not filed tax returns for several years.

At that time, income tax laws were favorable to real estate investors. My client had several partnerships where investors put up the money and he developed the properties. Because of the tax-shelter of his partnership interests, he knew he would not owe any taxes. Nevertheless, he had procrastinated for several years, and now he was getting nervous about it.

His records were a mess. I spent half my time each week at his office reconstructing his books. Whenever I came to a transaction that was not clear, I noted it for later follow up. We had a standing appointment each Saturday morning in his office when I would take up the follow-up questions with him. Then, the next week I would work some more. Also each Saturday, I presented him with my invoice for services for that week, and he paid me.

This went on for a couple of months.

One week, I worked many more hours than normal on his affairs and presented him with an invoice that was about twice what the others had been. He looked at it and said, “That’s a lot of money.”

Picture the following situation:

- I was 27 years old; he was in his 40s.
- I subleased a single-room office from another CPA; the client’s office had a wood-burning fireplace, wet bar, ice maker, full bath, and a sauna.
- My net worth was about equal to his petty cash fund.
- I owed a mortgage and a car payment, I had two children, and my wife did not work. The client owned the office building where we were meeting.
- This client was 75 percent of my practice. His business was paying my bills. There were over a thousand CPAs in public practice in Dallas. And every one of them was listed in the Yellow Pages.

Would you have been as nervous as I was?

But I looked the client in the eye, smiled confidently, and asked, “Why do you think the invoice is too high?”


Imagine my surprise when this multi-millionaire real estate developer flinched and answered nervously, “I didn’t say it was too high. I just said it was a lot of money.”


“Well, I did a lot of work this week.”

“No problem.” And he quickly wrote me a check.

Ten years later, when I sold my share of the firm to my partners, moved to Florida, and became a practice profitability consultant, this developer was still a client of my firm. And, in all those 10 years, he never again commented on my prices a single time! (Which means, of course, that I was not charging him enough.)

I learned two valuable lessons from this event:

 **Key Point:** Make the arrival of your invoices a regular occurrence in clients’ mail, not a remarkable event.

 **Key Point:** Second, often the client is more nervous about losing you than you are about losing the client.

In this case, he was afraid I would quit and leave him hanging.

A few years later, I learned another lesson about not compromising on prices. I fired a large audit client who tried to get me to work for less than I was worth. All employees have the right to quit their jobs if their boss insists on paying them less than the going wage. If you view your clients as your employers, we, too, have the right to refuse to work for less than other clients are willing to pay.



Key Point: One of the keys to my success has always been that I will not work for less than I am worth.

Oh my goodness! I lost that large client! Oh dear, what shall I do?

I'll tell you what I did; I went out and got some more clients—better clients. The nice thing about losing a large client is that you have time to do more marketing. Yes, it took several new clients to replace the one lost one. But they were each better clients who valued what I did and were willing to pay fair prices.

Chapter 13

Get It in Writing

You provide financial services to clients; you don't finance their businesses. Ensure that clients understand what you intend to do, what you are not going to do (with special emphasis on items you did last time that you now want the client to do, or items included in the price last time that are not included now), how you will determine the price, and when the client will pay.

One of the best ways to make certain that clients are clear on these issues is to put it in writing.

This chapter will discuss engagement letters, change orders, invoices, and termination letters.

Engagement Letters¹

Commonly, one engagement letter covers all accounting, auditing, and regular tax services to be provided during a year-long period. You don't have to issue separate letters for recurring services, such as monthly compilations or quarterly estimated tax returns. The AICPA's eMAP website advises separate letters for consulting services, unusual tax matters (such as a tax audit), and other special engagements.

As suggested by *eMAP: The Management of an Accounting Practice Handbook*, the following matters generally are addressed in an engagement letter:

¹ Much of this chapter is adapted from section 204.03 *Preparing an Engagement Letter*, AICPA Online Publications, eMAP.

- Addressee: Address the engagement letter to management. This may be the board of directors or an audit committee, in which case you may address the letter to the chairman of the board or committee.

Key Point: For closely held businesses, you may address the engagement letter to the owner individually and say in the scope paragraph, "...services which we are to perform for Any Company, Inc." This may be helpful if you have to call on the owner to make good on his or her personal guarantee to pay the corporation's liability to you. Consult your attorney for appropriate wording.

- Entity: Include the subsidiaries, divisions, and so on, if applicable, that are covered by the engagement.
- Financial statements: Include all statements to be compiled, reviewed, or audited, and the period covered by such statements.
- Tax returns: Specify the returns to be prepared by form name and number.
- Services to be provided: Describe the nature of the service or services to be performed in as much detail as necessary. Examples are accounting, tax, or MCS.
- Scope: A description of the scope of the engagement should include any limitations imposed or special procedures requested by the client.
- Special conditions: When appropriate, the letter may mention special aspects of the engagement, such as the use of a specialist or other auditor.
- Excluded services: Services excluded from the engagement should be specified. Language should be nontechnical and distinguish between separate services if a mix of services is being provided.
- Limitations of the service: Describe the inherent limitations of an audit, review, or compilation or engagements involving prospective financial information. For services not involving financial statements, indicate that they do not constitute an audit.
- Limitations on the use and distribution of your work product: Identify direct and indirect users—for example, by specifying that it is for the client's internal use only.
- Type of report: Mention the type of report you expected to issue, and indicate whether you anticipate that your opinion will be qualified for any reason. For new clients, you could include the anticipated wording of a compilation or review report so they won't be surprised or disappointed at the final report. Describe the general content of the expected report on an MCS engagement. The letter may indicate who the report will be addressed to and the number of copies you will provide. Mention other reports you may issue, such as a report on material control weaknesses or a management letter addressing reportable conditions.
- Client reproduction of the report: If you believe the client may reproduce the report in other printed material, the letter may provide that your approval is required for such reproduction.

- **Client responsibility for statements:** Explain that the client has the primary responsibility for the financial statements that your firm compiles, reviews, or audits. The statements are the responsibility of the client, even though the accountant may help maintain accounting records, suggest appropriate accounting principles, or prepare the client's financial statements. The engagement letter may mention that you will request written representations of management. Again, you don't want the client to have any unpleasant surprises.

Key Point: *Client assistance*—In the engagement letter, specify the assistance you expect the client to provide, such as preparing schedules and analyses, typing confirmations, and locating documents, including a timetable indicating when the client-prepared schedules will be needed.

When I was an audit partner, I always included a detailed list of the expected schedules as an exhibit to the letter. I also included a timetable of when the firm would need the client-prepared schedules.

- **Withdrawal:** Identify the situations in which you might withdraw from an engagement. This may avoid a claim for breach of contract. Effective provisions allow for the withdrawal if fees are not paid or if you believe that a potential breach of professional standards may occur unless you withdraw.
- **Timing:** Indicate when you will begin and complete the engagement. Indicate when you will deliver reports or tax returns. Cover the extent and timing of any interim work.
- **Invoicing procedures:** Include an estimate of the price or range of prices, allocated among the various services to be performed (for instance, audit and tax), if possible. Also cover the method you will use to determine prices, the frequency of invoicing, the treatment of collection costs and attorney's fees, interest on past-due balances, your right to suspend engagements in progress until unpaid balances are cleared, and any required deposit. Include the wording that the estimate is being based on the assumption that the client will provide assistance and that unforeseen developments may affect the price. The letter for a new engagement might discuss any arrangement you have made for startup costs.

Practice Tip—Some CPAs routinely volunteer to absorb startup costs even though clients have not broached the subject. This is lost income, because many clients expect to pay for startup costs.

- **Mediation:** Include a mediation provision, specifying that the client agrees to submit any engagement-related differences to mediation before resorting to litigation.
- **Site of engagement:** If you and the client are located in different states, agreeing in advance on the site of the engagement gives you the valuable choice of law and courts should there be engagement-related litigation.

- Designated representative: During the engagement, you will rely on the representations of the client. Have the client designate one person at the beginning of the engagement to serve as the client's spokesperson. This avoids different and often conflicting decisions by various members of management.
- Approval: Obtain the client's written acknowledgment of the terms of the engagement. A less desirable alternative is to ask for a response only if the client does not understand or agree with any of the terms. In any event, if the nature or scope of the engagement changes from preceding years, take this opportunity to initiate the use of an engagement letter approved by the client.

Let's put all these recommendations together, as shown in exhibit 13-1, "Sample Fixed-Price Agreement Letter." This sample is based on providing a high level of monthly consulting, in addition to the normal accounting and tax services. For a compliance client only, you could omit the paragraphs noted as optional. Note, in the letter, this agreement can be termed a "suggested arrangement" because of the satisfaction guarantee and the discretion of the client to pay more or less than the recommended price.

Exhibit 13-1: Sample Fixed-Price Agreement Letter*

[Date]

[Addressee Name]

[Addressee Address]

[Addressee City], [State] [Postal Code]

Dear [Addressee First Name]:

I am delighted to send you this suggested arrangement for an annual services arrangement with Any Corporation, Inc. (you), effective January 1, 20XY. This letter confirms our understanding as to the scope of the work that we will perform for you.

[The following clause is optional.] To improve communication between us, this letter clarifies the Gold Medal services we intend to perform for you (as described in the attached brochure and on our website) as well as your responsibilities under this arrangement.

20XX Professional Services

We will perform the following services for you during 20XY:

Service	Suggested Price
Prepare approximately 85 Forms W-2, "Wage and Tax Statements," for 20XX	\$XXX
Prepare your Form W-3, "Transmittal of Wage and Tax Statements"	XXX
Prepare approximately 126 Forms 1099-MISC, "Miscellaneous Income," for 20XX	XXX
[Include the state forms comparable to the above federal forms.]	XXX

Service	Suggested Price
Prepare your Form 1096, "Annual Summary and Transmittal of U.S. Information Returns," for 20XX	XXX
Prepare your Form 941, "Employer's Quarterly Federal Tax Return," for the period ended December 31, 20XX	XXX
Prepare your Form ABC, "State of Columbia Employer's Quarterly Tax Return," for the period ended December 31, 20XX	XXX
Prepare your Form XYZ, "State of Columbia Sales and Use Tax Return," for the period ended December 31, 20XX	XXX
Prepare your Form 940, "Employer's Annual Federal Unemployment (FUTA) Tax Return," for 20XX	XXX
Prepare your Form DEF, "Workers' Compensation Report," for the period ended December 31, 20XX	XXX
Prepare your Forms 941, "Employer's Quarterly Federal Tax Returns," for the periods ended March 31, June 30, and September 30, 20XY	XXX
Prepare your Forms ABC, "State of Columbia Employer's Quarterly Tax Returns," for the periods ended March 31, June 30, and September 30, 20XY	XXX
Prepare your Form XYZ, "State of Columbia Sales and Use Tax Returns," for the periods ended March 31, June 30, and September 30, 20XY	XXX
Prepare your Forms DEF, "Workers' Compensation Reports," for the periods ended March 31, June 30, and September 30, 20XY	XXX
20XX year-end accounting adjustments and closing of 20XX books	XXX
Prepare approximately 7 Schedules K-1 (Form 1120S), "Shareholder's Share of Income, Credits, Deductions, etc.," for 20XX	XXX
Prepare any bookkeeping entries we find necessary in connection with preparation of the income tax returns	XXX
Prepare your Form 1120S, "U.S. Income Tax Return of an S Corporation," for 20XX	XXX
Compile your financial statements for 20XX, with your personnel to provide the schedules and analyses attached as Exhibit A by March 3, 20XY	XXX
Annual consulting service for 20XY [^]	XXX
Total Professional Services for 20XY	<u>\$XXXX</u>

[^] Included in the annual consulting service are the following services we will provide you:

- Unlimited meetings to discuss the operations of Any Corporation, business matters, tax matters, and any other topic, at the discretion of Any Corporation or its employees and/or agents
- Unlimited telephone support for your personnel and/or your independent contractors and agents regarding accounting assistance, the recording of transactions, etc.

[This heading is optional.] **Recommended Price and Expenses**

[The following clause is optional.] Our price for this project will be at your discretion with a recommended minimum payment of \$____ per month for the first year.

Because our arrangement provides ongoing access to the business advice you need, you are not inhibited from seeking timely advice for fear of "the clock running." Our services are designed around value pricing, as opposed to cost-plus rates, and offer you access to our accumulated experience to help enhance your company's future and achieve its business goals.

As described in the attached brochure and on our website, this arrangement entitles you to unlimited consultation with us on operational issues relating to properly recording, classifying, or handling your business transactions. If your question or issue requires additional research and analysis beyond the consultation, that work will be subject to an additional price negotiation before the service is to be performed, and a change order will be issued before delivery of the additional service, with payment terms agreed to in advance.

Unanticipated Services

If an unanticipated need arises (such as, but not limited to, an audit by a taxing agency, or any other service not covered in this agreement), we agree to perform this additional work at a price mutually agreed upon before the service is provided. This service will be invoiced separately to you as part of a change order and will be payable upon presentation [or, payable according to the terms mutually agreed upon].

[This heading is optional.] **Service Guarantee**

[The following clause is optional.] As described in the attached brochure and on our website, we guarantee our work to your complete satisfaction. If you are not completely satisfied with our services, we will, at your option, either refund the price, or accept a portion of said price that reflects your level of satisfaction. We will assume you are satisfied upon payment received each month under the terms of this arrangement.

[The following clause is optional.] To assure that our arrangement remains responsive to your needs, as well as fair to both parties, we will discuss the monthly payment at any time throughout the year and, if necessary, revise or adjust the scope of services provided and the prices charged in light of mutual experience.

[The following clause is optional.] Our goal is 100-percent client satisfaction. This arrangement says "recommended fee" for a reason. If for any reason, you feel that any month's payment, when considered in conjunction with our entire relationship, is inappropriate, we want you to feel free to call to discuss a more appropriate amount, or you may adjust the following month's payment for whatever you believe the service was worth.

[The following clause is optional.] Because you are paying a nonrefundable (after one month) payment each month, your risk is limited to \$____.

[The following clause is optional.] If you wish to pay extra for any month, please consider your best estimate of the value we have brought to your company through this arrangement, but it is also acceptable to wait until the year-end to determine how much extra value we have brought to your company, if any.

[The following clause is optional.] We will communicate with you often, making recommendations to help you build a better business and building a win-win and long-term relationship with you. We expect you to communicate frequently with us, too.

In return for our commitment to your satisfaction, after we have worked with you for three months and you have a good perspective on what we can do for your business, we ask you to give consideration to referring us to at least one other business whom you believe would benefit from an association with us.

Quality Review

You agree, and hereby consent, to participate in our policy of internal quality review. We subscribe to a policy of quality review to maintain the highest quality of service from our firm. As part of this program, all major services performed under this agreement may be reviewed by another CPA within our firm under strict rules of confidentiality. The price for this review is included in the above professional services.

The “Fine Print”

Either party may terminate this arrangement at any time, for any reason, with 10 days of written notice to the other party. If you are not completely satisfied with our services, we will, at your option, either refund the current month’s payment, or refund a portion of the retainer that reflects your level of satisfaction.

[The following clause is optional.] You acknowledge that the proprietary information, documents, materials, management techniques, and other intellectual property we use are a material source of the services we perform and that these were developed prior to our association with you. Any new forms, software, documents, or intellectual property we develop in this engagement for your use shall belong to us, and you shall have the limited right to use them solely within your business. All reports, manuals, forms, checklists, questionnaires, letters, agreements (including this one), and other documents (which we make available to you) are confidential and proprietary to us. Any and all new documents created as a result of this arrangement will automatically become our property. Neither you nor any of your agents will copy or electronically store, nor reproduce nor make available to anyone other than your personnel, any such documents.

[The following clause is optional.] We agree to keep your proprietary information confidential.

[The following clause is optional.] We will base our business recommendations primarily on the data you furnish. We will not audit or otherwise verify data you submit. Although we believe our recommendations will be sound, the degree of success with which you apply our recommendations depends on factors beyond our control, including, but not limited to, the actions of your personnel, customers, competitors, regulators, and the condition of the economy (and naturally this list is not intended to be exhaustive). Managing your business requires careful attention because it determines the success and profit of your business. Therefore, subject to the following paragraph, you agree that our liability for damages, regardless of the form of action, shall not exceed the total amount paid for services under this arrangement for the most recent month. You further agree, subject to the following paragraph, that we are not liable for any lost profits, or for any claim or demand against you by any other party and you agree to hold harmless and indemnify us, including reasonable attorneys’ fees and costs, against any and all claims made as a result of our properly authorized actions performed under, or related to, (or both) this agreement. Neither party can bring an action, regardless of form, arising out of the services under this agreement more than one year after the party knew or should have known that it had the right to pursue the cause of action. We do not make any express or implied warranties, including, but not limited to, the implied warranties of merchantability and fitness for a particular purpose. Subject to the following paragraph, we will not be liable for consequential damages even if we have been advised of the possibility of such damages.

Notwithstanding anything to the contrary set forth in the preceding paragraph, our liability to you for damages incurred by you and actions or claims brought against you shall not be limited if such damages, actions, or claims are attributable to our gross negligence, our unauthorized acts, our willful misconduct, our libel or slander, (or both), or our unlawful conduct. In addition, you shall not indemnify and hold us harmless for any claims or actions against us resulting from our negligence or our unlawful conduct.

To confirm the arrangement, please return a signed copy of this agreement with your check for \$____ for the payment for January 20XY. Each month's payment is payable in advance on the first of each month. If you like, we can arrange to charge each retainer to a major credit card or we can invoice you. Just let us know which you prefer.

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

Very truly yours,

[CPA firm]

By:

Agreed to and authorized:

By: Date:

Client:

**Adapted with permission of Aspen Publishers, 2001, Ronald J. Baker, The 2001 Professional's Guide to Value Pricing, pages 131–134, www.aspenpublishers.com.*

Include Realistic Payment Terms in the Engagement Letter

Providing for payment “upon presentation” or “when invoices are rendered” is not realistic for most clients. This may cause them to not take your payment terms seriously. The following examples will achieve your actual collection goals, and most clients will be able to accommodate these terms. Your attorney should review any language regarding interest, late charges, collection costs, and so forth for compliance with your local laws.

Example: Invoices will be rendered every 2 weeks and are payable within 10 days of invoice date.

Example: All invoices are due and payable within 30 days.

Example: Our policy is to invoice every two weeks for services and costs. Payment is due by the end of the month in which invoices are rendered, except for invoices dated in the last 10 days of a month, which are due by the 10th of the following month.

Example: We will invoice you monthly. Our invoices are payable within 15 days. Amounts outstanding at the end of the month will bear interest at ____ percent per annum. Further, we will not commence additional services if any balance is delinquent. You agree to pay any reasonable attorney fees and collection costs incurred by us in connection with your balance.

Example: Our firm policy requires a retainer of \$____, to be applied against the final invoice.

Example: Invoices to the corporation are personally guaranteed by [owner-manager]. (Author's Note: In this case, the engagement letter should be signed by the

owner-manager personally, in addition to his or her signature as corporate officer. Your attorney should suggest specific language.)

Example: Your returns, of course, are subject to review by the taxing authorities. [Or, “The outcome of any litigation is subject to review or reversal by a higher court.”] Any items resolved against you by the examining agent are subject to certain rights of appeal. [Or, “Any damages awarded...,” or “Any zoning permits obtained...,” and so forth.] In the event of an examination [or, “appeal” and so on], we will be available upon request to represent you and will charge you for these additional services.

Allow for Value Pricing in Your Engagement Letters

Many firms’ standard engagement letter terms do not allow for charging above standard rates, even if justified. Instead, such letters include a provision such as, “Our fees will be billed as work progresses and are based on the amount of time required plus out-of-pocket expenses. Invoices are payable upon presentation.” Or,

“We estimate that our fee for this project will range from \$____ to \$____. Our policy is to bill every two weeks for services and costs. Payment is due when invoices are rendered. We will keep you informed of our progress during the engagement. If we spend less time than our estimate, we will bill you the lesser amount. If we encounter extraordinary problems that could increase the quoted fee, we will inform you immediately. You have agreed to pay us a \$____ (50 percent) retainer to apply against the final billing.”

Exhibit 13-2, “Sample Value Pricing Language for Engagement Letters,” gives illustrative language that allows you to value price when appropriate.

Exhibit 13-2: Sample Value Pricing Language for Engagement Letters

We generally base our prices on the time invested at our regular rates for the services and personnel assigned plus out-of-pocket costs and relevant computer charges. [Author’s Note: The use of the word generally allows for exceptions.] However, our charges also may include other appropriate factors, including the difficulty of the assignment, the degree of risk and responsibility the work entails, time limitations imposed on us by others, the experience and professional expertise of the personnel assigned, and the priority and importance of the work to the client.

Assuming adequate records, internal controls, and assistance of your personnel, we estimate that our price for the [services] could range as high as \$____. [Author’s Note: Quote only the top end of the range. If you quote the lower end of the range, that is what the client will remember.] We will attempt to minimize our fees without sacrificing the quality of our work. The extent to which we can depends on the availability of your personnel to offer us clerical and other assistance to prepare schedules, perform analyses, and provide source documents. If we encounter significant unusual circumstances not contemplated in preparing the estimate, we will discuss them with you and arrive at a new price estimate before we incur additional costs. [Author’s Note: Accountants often omit these contingencies from engagement letters. But this omission makes it easy for the client’s personnel to avoid helping the accountant.]

We have based the estimated price on the assumption that you continue to employ competent, experienced bookkeeping and accounting personnel. If a change in your personnel requires us to spend extra time to train your people or otherwise perform our services, we will invoice you for such extra time. [Author's Note: You might use this language for a client who has had high turnover in their accounting department.]

Change Orders

If new services arise that you did not specify in the arrangement letter, prepare a change order for the client's approval. See exhibit 13-3, "Sample Change Order," and exhibit 13-4, "Sample Change Order for Scope Change." Most change letters follow the form of exhibit 13-3. Exhibit 13-4 shows the part that is different.

Exhibit 13-3: Sample Change Order

Client: Any Company Inc.

Date: November 10, 20XX

Project Description: [CPA firm] will represent Any Company Inc. before the Internal Revenue Service (IRS) for the audit of their 20XX U. S. Corporation Income Tax Return, Form 1120, for the issues as described in the IRS letter dated November 1, 20XX.

Any Company Inc. hereby agrees that its accounting department will provide all records, documentation, and schedules deemed necessary by [CPA firm].

Price and Terms: Based upon our knowledge of the IRS's concerns and issues to be examined, we hereby agree to represent Any Company Inc. for the fixed price of \$____, payable 50 percent upon approval of this project and 50 percent upon completion of the audit.

If, in the course of the audit, the IRS raises other issues outside the scope of the IRS letter mentioned above, we and you will enter into another change order at that time, at a mutually-agreed upon price.

If you agree with the previous project description and the price, please authorize and date the following change order. A copy is enclosed for your records.

Thank you for letting us serve you.

Very truly yours,

[CPA firm]

By:

Agreed to and authorized:

By: Date:

Client:

Exhibit 13-4: Sample Change Order for Scope Change

Client: Any Company Inc.

Date: August 20, 20XX

Project Description: During fieldwork of the audit for the year ended December 31, 20XX, we discovered that the Prepared By Client (PBC) Schedules listed in exhibit A to the engagement letter were not accurately completed, in a timely manner, by your accounting staff.

To complete the audit in a timely manner, both parties agree that we will now complete the PBC Schedules, a service we did not originally anticipate in our price for the audit. Both parties agree that the price for this service is \$____, payable upon authorization of this change order.

Use the Invoice to Increase Client Satisfaction

I have reviewed thousands of invoices sent by perhaps a hundred or more accounting firms over the years. The following sections describe the characteristics of the better billers in terms of appearance, language, detail, and the handling of higher-than-expected invoices.

Appearance of the Invoice

There are ways to make your invoice easier to read:

- Print all invoices using Times New Roman, 12-point type.
This sentence is an example of 12-point type.
- Do not use initial capitals.
Initial Caps May Be Appropriate For Major Groups Of Accounts On Financial Statements, But—As You Can See From Reading This Sentence— They Are A Bit Much For The Text Of Invoices.
- All capital letters are more difficult for people to read, as the following sample shows:
THEY SHOULD NOT BE USED BECAUSE OF THEY DISTRACT THE READER AND ARE HARD TO READ.
- All invoices should be on letterhead, not printer paper. You want to be perceived as a first-class firm. Use first-class paper and envelopes.

Language of Invoices


Use the right words to describe what you did. Follow these suggestions:

- Use “telephone consultation and follow-up” in preference to “telephone call,” if the telephone call involved a follow-up.
- Similarly, use “consultation” instead of “discussion.”

- Use “conference” instead of “meeting.”
- Use the word “research” whenever possible. This communicates the value of your services to the client.

Details of Invoices

Generally, the more detailed explanation you give clients, the better, especially regarding any potential savings or profits you have helped the client to achieve. As one California CPA put it:

 **Key Point:** The more you write, the more you can charge.

- Describe any item that significantly increased the price over the prior period.
Example: Any of the following can be used to describe the various federal, state, and local individual income tax returns prepared:
 - “...including reworking tax return for changes by client”
 - “...including accounting for commodity transactions”
 - “...including the calculation of basis from inheritance and accounting for equipment and cattle purchases and sales”
 - “...including research on deductibility of IRA”
 - “...including correspondence during 20XX with Department of Revenue of West Virginia and preparation of tax projection regarding timber sale and related work”
- Describe any item that caused a higher price than the client expects.
Example: Describe various accounting services rendered for the month of July 20XX, by writing, “...including analysis of business transactions through July 20XX.”
- Give detailed explanations of services rendered on invoices, but give only one amount due. This makes the nature of your services more visible. Here is an example of one such invoice sent by one of my clients:
Example: For professional services rendered through April 30, 20XX:
Analysis of Accounting Records for Tax Purposes
 Preparation of the following payroll tax returns for the quarter ended March 31, 20XX:
 - Form 941 Employers Quarterly Federal Tax Return
 - Form XXX State Employment Security Quarterly Report
 - Form XX Employers Return of State Income Tax Report
 Accounting services for the month of March 20XX:
 - Reconciliation of checking account
 - Preparation of cash receipts and cash disbursements journal
 - Preparation of check register
 - Posting of transactions to general ledger
 - Preparation of detailed general ledger

Preparation of compiled financial statements including:

- Balance sheet as of March 31, 20XX
- Income statement for the month of March 20XX and for the three months ended March 31, 20XX, with comparative figures for 20XX

Statement of cash flow for the month of March 20XX and for the three months ended March 31, 20XX, with comparative figures for 20XX

Preparation of payroll checks

Amount Due \$ _____

Exception: If you did extra work on a fixed-price engagement, or for a monthly-retainer client, show the fixed price or regular work as one amount, and list the extra work below with one amount for all extra work.

Example:

Regular accounting work for the month of July \$900.00

Extra work:

- Accounting for sale of Beaver Street rental property
- Accounting for sale of [description] under new capital gains rules
- Preparation of [description of various tax returns]
- Total extra work \$950.00
- Balance due \$1,850.00

Also, you can add a single line item for any reimbursable expenses such as messenger service, overnight shipping, travel, the printing of extra copies of reports, and so forth. Reimbursable expenses should be an exact amount and should be in agreement with your WIP run to the penny, in case a client ever asks to see backup.

CAUTION: Never invoice for a reimbursable expense of less than \$20 or so. Clients hate to be “nickel-and-dimed.”

- Generally, do not invoice amounts less than \$100. It causes clients to conclude that you deal in trivia.
- List any state income tax returns and all estimated returns as separate line items.

Example: The following is a list of returns prepared:

- Preparation of Form 1040, 20XX, U.S. Individual Income Tax Return for John and Mary Smith
- Preparation of Form 1040ES, 20XY, U.S. Declaration of Estimated Income Tax for John and Mary Smith
- Preparation of Form XXX, 20XX, Pennsylvania Resident Personal Income Tax Return for John and Mary Smith
- Preparation of Form XXX, 20XY, Pennsylvania Declaration of Estimated Income Tax for John and Mary Smith

- Preparation of Form XXX, 20XX, Ohio Nonresident Individual Income Tax Return for John and Mary Smith
- Preparation of Form XXX, Pennsylvania 20XY, Intangible Tax Return
- Consultation regarding 20XX Metropolis County property tax assessment and review of proposed assessment
- Consider listing each tax schedule and form number included with the returns. One of my clients provides detailed explanations like these for very expensive individual income tax returns.

Example:

Form 1040 U.S. Individual Income Tax Return

- **Schedule A, Itemized Deductions.** This schedule reports deductions allowed for medical expenses, taxes, interest, contributions, and other miscellaneous deductions.
- **Schedule B, Income from Interest and Dividends.** This schedule reports interest and dividend income.
- **Schedule C, Profit or Loss From Business.** This schedule reports results of your business activity. The second schedule C reports income from working interests in oil and gas.
- **Schedule D, Capital Gains and Losses.** This schedule reports gains and losses from the sale of investments and gains and losses passed through to you reported on Forms K-1 and from Forms 1099-B reported from brokerage firms.
- **Schedule E, Supplemental Income and Loss.** This schedule reports income from rental activities that otherwise are not formal partnerships or S corporations. This schedule also reports income from royalties.
- **Schedule E, page 2, Supplemental Income and Loss.** This schedule reports net allowable losses and income from K-1 activities and includes all partnerships and S corporations.
- **Form 4562, Depreciation and Amortization.** This schedule reports allowable deductions for depreciation that end up being deducted from either schedule C or schedule E.
- **Form 4797, Sales of Business Property.** This schedule reports gains from Forms K-1 having to do with dispositions of property within those entities.
- **Form 4835, Farm Rental Income and Expenses.** This form reports both the Nowhere County farm and the Somewhere County farm operations.
- **Form 4952, Investment Interest Expense Deduction.** This form calculates deductible interest expense.
- **Form 6251, Alternative Minimum Tax.** This form calculates the tax due under the alternative minimum tax rules and compares the amount of tax calculated under the normal tax rate calculations.
- **Form 8582, Passive Activity Loss Limitations.** These forms are required to be calculated in two ways. The first computes allowable losses that can

- be deducted or suspended for regular tax purposes. The second calculates amounts deductible for purposes of the alternative minimum tax calculations.
- **1040ES, Estimated Tax Vouchers for 20XX.** These forms are used to prepay your 20XX tax. They were prepared using the safe harbor method.
- **ST Form SS, State Individual Income Tax return.**
- **ST Form SS-ES, State Estimated Tax Vouchers for 20XX.**
- Also detail any data preparation or sorting you had to do because the client did not give you his or her information in good order.

How to Handle a Higher-Than-Expected Invoice

Fortunately, the way clients react to bad news depends on how you tell them. Do not turn off clients by telling them “no” or giving them bad news without preamble.

Example: If your invoice is more than you expected, don’t start with, “This is going to cost you more than I thought.” Instead, begin by explaining the facts on which you and the client based the original estimate, then show how those assumptions were in error (through no fault of yours, I hope), and the effect on your price estimate. Remind the client that your original estimate was only an estimate, and get his or her agreement to adjust your price before you proceed.

Remember the expression, “Play the offense, not the defense”? As soon as you know or can anticipate a problem, take the initiative and call the client. Do not wait for the client to call you.

Client Termination Letter

If clients are not paying you, they are not clients. You have no ethical obligation to work without pay. In fact, it is unfair to your other clients. See exhibit 13-5, “Sample Client Termination Letter for Nonpayment of Account.”

Exhibit 13-5: Sample Client Termination Letter for Nonpayment of Account

We have received no response from you to our repeated requests for payment of our invoices to you (copies attached) of \$____. Our policy is to discontinue service to any client whose account remains unpaid more than 30 days. Consequently, we must inform you of our decision to discontinue services. We would like to continue our relationship with you, but we must be paid for our services.

We have discontinued all services we are currently providing you as of this date, and we can accept no further engagements. [*The following clause is optional.*] We have requested our legal counsel to initiate legal action to collect our invoices.

We hope you will send your check today so we can again serve you in the future. [*The following clause is optional.*] We are returning your documents which were in our possession.



Glossary

adjustment, fee—See *write-down* and *write-up*.

allowance for doubtful accounts and billing adjustments—A provision for standard fees that may not be invoiced (*write-downs*) or that may be invoiced and not collected (similar to the adjustment made for bad debts of a commercial client). Bad debts are for inactive clients. For active clients, refer to *billing adjustment* or *write-down*.

allowances, fee—See *write-down* and *write-up*.

billable hour—See *chargeable hours*.

billed accounts receivable—See *receivables, invoiced*.

billing adjustment—See *write-down* and *write-up*.

billing rate—See *chargeout rate*.

CFP—certified financial planner.

chargeable time—Any time spent that can be identified with serving a specific client. Some professionals distinguish between *billable time* and *chargeable time* based on whether they take a *write-down* (defined later) or *billing adjustment*. In order to have a common vocabulary, in this book, *chargeable time* is all time that is identifiable with serving a particular client regardless of whether there was a write-down on the account.

chargeout rate—The amount per hour charged to work in process for a service. See also, *effective chargeout rate* and *standard chargeout rate*.

client expenses—See *direct client expenses*.

costs recoverable from clients—See *direct client expenses*.

deliverable—Professional services usually provide some tangible evidence of the services, such as a document, a tax return, a tax opinion letter, a written financial plan, or a financial report. Some accountants referred to these tangible representations as *deliverables*. Nevertheless, the service itself is intangible.

desktop time—Chargeable time spent at the accountant's office alone or with other team members when a client is not present.

direct client expenses—Expenses incurred that are charged directly to the client's *work in progress* and covered in client invoicing. These include travel, supplies, reproduction costs, postage, telephone, outside services and consultation, and other expenses and do not appear on the firm's income statement either as revenue or expense. Also called *costs recoverable from clients* and *reimbursable costs*.

direct expenses—Personnel compensation and direct client expenses.

direct personnel—Owners and technical staff but not support personnel.

effective billing rate—See *effective chargeout rate*.

effective chargeout rate—Net sales divided by chargeable hours (for a person, department, office, or firm).

engagement letter—A letter written by the CPA firm to the client documenting the mutual understanding and agreement about the nature and terms of the engagement and the degree of responsibility the firm will assume in providing the subject services. Sometimes referred to as *arrangement letter*, *terms of reference*, *terms of engagement*, or *engagement contract*. The letter may cover other items such as price (or method of determining price), payment terms, type of report to be issued, how the report may be used, limitations on the scope of the engagement, assumptions on which the engagement is based, and assistance the client will provide. In some professions, engagement letters are not a professional requirement, but they are usually a matter of good business practice.

fieldwork—Engagement work done outside the firm's office, often at the client's location.

firm administrator—The most senior-level executive on the support team, responsible for office administration and supervision of the support personnel. In some firms, the firm administrator is also responsible for the firm's management information system and other duties. Also called *office manager* or *business manager*.

FTE—Full-time equivalent.

GAAP—Generally accepted accounting principles.

gross fees—See *standard fees*.

indirect expenses—See *overhead*.

Key Performance Indicator—A selected measure that evaluates the success of a particular activity of a business in a specific area. KPIs enable business decision-makers to take actions to achieve desired business goals.

ledger—The book of business or list of clients for whom a PIC has primary invoicing responsibility.

leverage—The total number of people in the firm, department, office, or other practice unit divided by the number of owners.

lockup—1) Total amount of invoiced receivables and work-in-process, net of allowances for doubtful accounts and billing adjustments. 2) To calculate days of lockup, add accounts receivable (invoiced receivables), net of allowance for doubtful accounts, to work-in-process (un-invoiced receivables), net of allowance for billing adjustments. Divide that sum by net sales for the last 12 months (amounts invoiced adjusted for changes in work-in-process), and multiply the result by 365.

mandatory services—Routine periodic write-up, financial statement preparation, compilation, review and audit services; including the preparation of routine sales tax and payroll tax returns and tax reporting forms that require no element of judgment and routine worker's compensation audits.

margin—Economic gross profit percentage on standard fees, before write-downs.

markup—See *write-down* and *write-up*.

MCS—Management consulting service.

MIS—Management information system; the accounting and reporting system which provides operating information useful in making management decisions.

net fees—See *net sales*.

net sales—The amount invoiced for a particular service or engagement, as compared to standard fees. Standard fees plus or minus write-ups and write-downs.

net income—The amount remaining for distribution to the owners of a practice after paying all other expenses such as rent, staff payroll, taxes, facilities, and so forth.

nonchargeable hour—An hour spent that is not chargeable to a client. This includes training, recruiting, professional meetings, practice development, administration, and firm meetings, regardless of whether the time is spent during regular business hours or not. It also includes civic activities, vacations, holidays, sick leave, paid personal time, and authorized leaves of absence during business hours.

opportunity cost—The measurable value of benefit given up by forgoing a favorable or advantageous opportunity in favor of another. The value of either a sacrifice made or a chance for progress or advancement.

overhead—Indirect operating expenses such as rent, utilities, taxes, interest, training, and professional expenses, but excluding salaries and wages and direct client expenses.

overtime—Hours spent on both chargeable and nonchargeable activities in excess of standard hours.

owner—A partner or significant shareholder of a professional service firm. All owners are assumed to be active executives in the firm. Employees below executive level owning nominal interests in the firm are not included in this definition.

PIC—Person in charge; the executive responsible for managing the firm's services to, and invoicing for, a particular client or engagement. The person to whom the client would first turn for a question regarding the client's service or invoice.

planned write-down—A write-down that was anticipated before the engagement was accepted and agreed to for marketing or other reasons. For example, an engagement anticipated to cost \$14,000 at standard rates is undertaken for an agreed fee of \$10,000. \$4,000 is the planned write-down. If the engagement is performed for \$15,000, \$4,000 of the total \$5,000 write-down is planned. The PIC would only be held responsible for \$1,000 as an unplanned write-down. If the engagement is completed for \$12,500, the planned write-down is still \$4,000, and the PIC would be recognized for a \$1,500 write-up.

productivity—See *utilization*.

realization—The percentage or amount of standard fees invoiced.

reimbursable costs—See *direct client expenses*.

spur question—A question which calls a person's attention to a dissatisfaction with some area of his or her life and motivates the individual to want to improve that area.

standard—Usually refers to *standard chargeout rate* or *standard fees*.

standard billing rate—See *standard chargeout rate*.

standard chargeout rate—The fee per hour established by the firm for each person in the firm.

standard fees—Total chargeable hours times the applicable standard chargeout rates. Also known as *gross fees*.

standard hours—Multiply 8 hours per day by 5 days a week by 52 weeks a year, or 2,080 hours per year. In some countries, standard is 7 hours per day, or 1,820 hours per year.

support personnel—Administrative, office, and clerical personnel whose primary function is to support the client-service efforts of the *technical staff*. Support functions include typing, proofing, copying, printing, binding, messenger service, and invoicing. Support personnel may work on many different clients each day. They normally work in the firm's office.

technical staff—Technically trained personnel whose primary function is to work directly with or for clients, usually one client at a time, and often in the field.

total hours—Annual chargeable and nonchargeable hours (includes overtime, holidays, vacations, sick leave, and so on).

utilization—Average annual chargeable hours per person. Also, the number of chargeable hours divided by total hours.

value pricing—Pricing services based on their value to clients, rather than on the CPA's cost to provide them.

VAS—Value-added services; tax return preparation that requires an element of judgment, consulting and planning services, whether personal, financial, or business. This includes sales or use tax examinations (or both) because they require extensive negotiating skills. It does not include sales and use tax or payroll tax services; these are more in the nature of accounting services.

WIP—Work in progress; the amount attributed to work performed for clients (the chargeable hours times the standard chargeout rates plus direct client expenses incurred) but not yet invoiced, often stated at standard fees. If stated at standard, an allowance for possible write-downs is usually deducted from the total in presenting the firm's financial statements. Some firms value WIP at cost instead of at standard rates.

write-down—The amount by which standard fees (including direct client expenses) are reduced to arrive at the amount invoiced (net sales). Like write-ups, write-downs are often expressed as a percentage of standard fees. Other terms used are *billing adjustments*, *markups* and *markdowns*, *pluses* and *minuses*, *allowances*, and *fee adjustments*.

write-up—The amount added to standard fees and direct client expenses to yield the amount invoiced. Like write-downs, write-ups are often expressed as a percentage of standards fees. Other terms used are *billing adjustments*, *markups* and *markdowns*, *pluses* and *minuses*, *allowances*, and *fee adjustments*.

