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American Institute of Certified Public Accountants

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PRACTICE AIDS

SMALL BUSINESS CONSULTING PRACTICE AID **14**

Assisting Professional Clients in Pricing Services Using Budgeting Techniques

AICPA
American Institute of Certified Public Accountants

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MAS practice aids are designed as educational and reference material for members of the Institute and others interested in the subject. They do not establish standards or preferred practices. The standards for MAS practice are set forth in the Statements on Standards for Management Advisory Services (SSMASs) issued by the AICPA. However, since the services described in this series of practice aids are management advisory services, the standards in the SSMASs should be applied to them as appropriate.

Various members of the 1988–1989 AICPA MAS Small Business Consulting Practices Subcommittee were involved in the preparation of this practice aid. The members of the subcommittee are listed below.

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Preface

This MAS practice aid is one in a series devoted to the kinds of management advisory services most often provided to a CPA's small business clients. Even though the same services may also be provided to large clients, practitioners' experience indicates that providing advice and assistance to small, closely held businesses often involves different considerations. Small businesses frequently do not find it cost-effective to have the breadth of financial and accounting expertise that is present in larger businesses. Hence, the nature and depth of the practitioner's gathering and analysis of data may differ when providing services to small and large businesses. Most important, the personal plans, finances, and desires of the small business owner may have a significant impact on the current and future operations of the business, and the practitioner must take them into consideration.

MAS small business consulting practice aids do not purport to include everything a practitioner needs to know or do to undertake a specific type of service. Furthermore, engagement circumstances differ, and, therefore, the practitioner's professional judgment may cause him to conclude that an approach described in a particular practice aid is not appropriate.

For members employed in industry and government, MAS small business consulting practice aids contain information that may be useful in providing internal advice and assistance to management.

Contents

Scope of This Practice Aid

Professionals, such as attorneys and doctors, often don't completely understand how much their operations cost and how to price their services. They therefore frequently ask CPA practitioners to advise them on this subject. This practice aid provides practical information to practitioners who help clients determine and evaluate billing rates for time-related professional services.

Engagements of this kind often include analyzing and evaluating costs, a service well suited to most practitioners based on their experience and training. Practitioners can also design, based on training and experience, a pricing model to help clients establish or evaluate a pricing system.

The fact-finding and analysis described in this practice aid, as well as the time and cost budgets prepared in this type of an engagement, provide the practitioner with the information to advise the client on many profit planning issues not directly considered in this document. These issues include cost control, level of staffing and mix of staff experience and ability, and profitability by type of service. These variables, in addition to pricing, influence the profitability of a professional firm.

Perhaps the most straightforward pricing model is one that uses current operating costs and the professional client's targeted profit to establish standard billing rates. An example based on this approach is illustrated in the Appendix. However, a *targeted-profit* approach to pricing will not be useful when the resulting billing rates may not be in keeping with local competition or pricing norms for the profession. In such cases, the practitioner might help the professional client establish an alternate pricing model, such as value billing, that is not related to a targeted profit. Value billing assigns hourly rates in excess of standard rates or uses premium flat rates for services that have exceptional worth to the client. The practitioner may also assist the client in reducing operating costs so that the targeted profit could be achieved with lower standard billing rates or reduced hours of effort.

This practice aid does not address pricing models or techniques such as value billing or developing billing ranges other than a standard billing rate. However, practitioners need to be prepared to apply other means of assisting the professional client in pricing services if standard billing rates, determined on the basis of current costs and targeted profits, are inappropriate or unacceptable.

The illustrative case study in this practice aid describes a service-pricing engagement for a fictitious law firm. Practitioners can modify the work phases shown in the case study to satisfy the unique needs of different clients that provide other types of time-related services.

Definitions

Available billable hours. The total number of hours in a year that are available for an individual professional to provide billable services (that is, total number of annual hours, including base hours and projected overtime hours, reduced by projected nonbillable time, such as professional education, vacations, holidays, and administrative or marketing activities).

Base hours. Hours per year computed as standard hours per workday, assumed to be 8, multiplied by the number of potential workdays per year. In the example, this is 261 days (365 days per year minus 52 weekends [104 days]) times 8 hours per day. Base hours are thus 2,088 hours per year. No allowance has been made for vacations and holidays.

Billable expenses. Costs normally reimbursed by clients that are directly related to provision of services (for example, travel and materials). The professional firm's policy determines which costs to invoice directly to the client and which to count as part of the firm's overhead. These expenses might include telephone calls, copying, secretarial support, supplies, and messenger services.

Cost of service. Costs associated with direct labor, including base salary, payroll taxes, bonuses, overtime, and fringe benefits, such as pensions, medical benefits, life insurance, and out-of-pocket professional education.

Estimated billable hours. The total number of hours in a year that an individual professional spends providing billable services to clients. It is equal to the utilization percentage multiplied by available billable hours.

Overhead. Expenses such as rent, insurance, and utilities not included in cost of service or billable expenses.

Owners' imputed salary. The "base salary" the client establishes as the owners' assumed compensation for their professional services. This amount can be viewed as the compensation an employee would receive for comparable services.

Realization percentage. Derived by dividing the amount of collected fees by the billings, the realization percentage uses the standard billing rates. (Discounts from standard billing rates and write-offs or value billing rates in excess of the standard billing rate explain the differential.)

Standard billing rate. The hourly billing rate established as the target rate for services performed.

Utilization percentage. A percentage that is derived by dividing estimated billable hours by available billable hours. This figure measures the professional client's ability to effectively control nonbillable time, both idle time and demands placed on the professional (public service, for example) that are nonbillable.

Engagement Considerations

A practitioner may provide a client with advice and assistance in determining professional billing rates as a result of his or her own recommendation to the client or a client's unsolicited request. The practitioner may consider the following in deciding whether to recommend or undertake the engagement for either an existing or a new client:

- Is the client willing to accept the formal targeted-profit percentage formula for pricing its services?
- Would the client gain insight into the economics of its firm from a pricing assistance engagement?

After the practitioner agrees to accept the engagement, he or she should reach a clear understanding with the client about the service to be performed, including the scope and limitations of the engagement or consultation. In particular, the practitioner and the client need to discuss the client's goals for the new pricing strategy. The practitioner can outline this understanding in an engagement letter, which is advisable.[1]

The scope of involvement can vary greatly. A service-pricing engagement may require data gathering, preliminary evaluation, and implementation of accepted recommendations or may involve only preparing data for client management to evaluate. The latter may be limited to a consultation based on the practitioner's knowledge of pricing techniques, current economic conditions, and the client's situation. The extent and nature of the practitioner's work depend on the client's sophistication and circumstances.

A practitioner needs to recognize, and explain to the client, that market forces will ultimately have the strongest influence on billing rates. The market price for professional services is affected by factors such as demand, competition, and service differentiation through special expertise and above-average quality of service. With this information, the practitioner calculates standard billing rates based on known costs, projected utilization of personnel, and targeted profits. Such standard billing rates can be compared to market rate ranges. Standard billing rates form a basis for comparison with billing rates made on some other basis, such as value billing.

1. For information on MAS engagement understandings, see Statement on Standards for Management Advisory Services (SSMAS) No. 2, *MAS Engagements* (New York: AICPA, 1982).

Engagement Approach

A service-pricing engagement typically consists of four main phases. The phases are further broken down into steps (tasks), and the number of steps can vary, depending on the engagement. The practitioner chooses the steps that are applicable to a particular situation.

The four phases common to most service-pricing engagements are as follows:

Phase 1—Fact-Finding. The practitioner gathers data to gain a thorough understanding of the client's business, particularly the costs of client operations and income objectives. The practitioner may also ask preliminary questions to identify the factors of greatest importance to the client. This phase may be significantly abbreviated for engagements involving a client of long standing.

Phase 2—Data Analysis. The practitioner analyzes the information obtained in the fact-finding phase to understand the cost and organizational structures of the client.

Phase 3—Conception and Design. The practitioner develops a preliminary pricing model based on information from phases 1 and 2. The practitioner then reviews the preliminary pricing model with management and, based on their input, makes necessary revisions to the pricing model.

Phase 4—Implementation. The practitioner helps the client revise costing systems and billing methods to implement the pricing model and realize its full benefits.

The following sections discuss each phase in greater detail.

Phase 1—Fact-Finding

Preliminary Questions

In gathering data, the practitioner may ask the following preliminary questions:

1. What types of professional services does the client provide to its customers?
2. What financial information, including cost information, does client management receive? Is the information reliable?
3. How does the client determine billing rates at present, and how often does management review them?

Relevant Factors

Since various operational, financial, and market factors affect a client's billing rates, the practitioner needs to gather information about them. Documents and data to collect include the following:

- Historical financial information, such as financial statements, budgets, and a comparison of actual results to budget projections

- Cost accounting and billing systems information
- Data on billable and available hours for each staff member
- Accounting controls information
- Profit by department or by category of service
- Break-even calculations
- Ratios in total and by specialty (for example, utilization, billing rates per hour, and pretax profit to total fee income)
- Historical pattern of rate changes
- Long-range projections and plans

To understand how expenses influence billing rates, the practitioner examines the present method for accumulating service costs (such as time and expense reports) and projects the cost of services for each staff classification by aggregating the following:

1. Base salary, including imputed salary for owners or partners
2. Bonuses
3. Overtime compensation
4. Payroll taxes
5. Retirement plans
6. Group insurance
7. Professional education plans

The practitioner also reviews the method for prorating or allocating operating expenses between billable expenses and overhead.

To understand the client's philosophy and actual practices of staffing and its effect, the practitioner reviews the availability of unassigned professional staff in general and identifies individual professionals (and their classification) who are spending time on nonbillable activities. The practitioner considers allocation of shared staff between the administration activity and different services or departments, if applicable. The issue of appropriate levels of staff may also require the practitioner's attention as part of the engagement.

In addition, the effects of the business's volume, inflation, the cost of borrowing money, and the carrying cost of accounts receivable and work in process all require scrutiny, as does the client's policy and practice concerning progress billings.

Phase 2—Data Analysis

The practitioner carefully analyzes the data gathered, beginning with information that can affect billing rates. Points to cover include the following:

- Review the present method, if any, of calculating billing rates, and obtain a sample of the current calculation.

- Determine the projected number of available billing hours per year for each professional by using the following formula:

  $a + b - (c + d + e + f + g)$

  a = base hours
  b = projected overtime hours
  c = vacation hours
  d = holiday hours
  e = sick leave and personal hours
  f = professional education hours
  g = administrative, marketing, and public service responsibilities stated in hours per year

- Analyze the accuracy, timeliness, and completeness of time reports, the current method for accumulating the data, and how the information contributes to formulating a fee structure.
- Determine if the method for prorating or allocating operating expenses is reasonable.
- Study the cost accounting and accounting control systems to uncover any possible weaknesses.
- Determine whether the existing ratio of pretax profit to total investment is adequate to compensate the owners for their investment and risk (see the section entitled "Final Report" on page 8 for suggestions if owner compensation is inadequate).

With this supporting information, the practitioner can now ask focused questions, such as the following, about the billing process and billing rates that will help in setting new rates:

- What influenced rate changes in the past?
- Does the current method of calculating billing rates accurately include all cost factors?
- How is profit added into the billing rate?
- In comparing total estimated billable hours to total estimated number of available hours, is the estimate for billable hours realistic?
- What are the policies and procedures for invoicing hours and fees charged to a job or client?

As in the first (fact-finding) phase, the practitioner may prepare an interim report to client management, documenting possible weaknesses and stating preliminary conclusions.

Phase 3—Conception and Design

The practitioner develops recommendations based on the results of the fact-finding and data analysis phases and discussions with management. Some recommendations may address areas relating to the billing process in general, such as billing policies and practices, cost accumulations, and accounting methods. For example, the client needs to segregate operating expenses between billable expenses and overhead and, with the practitioner's help, determine a uniform factor to allocate overhead proportionately by job classification, department, or service category. The client may also need to design a form to accumulate these cost components and others, such as cost of services, for use as a tool to develop a billing rate formula.

The practitioner can now help the client develop a new standard billing rate. To test the accuracy of the new rate, the practitioner takes a representative sample of services recently billed by using the client's old rate and recalculates them using the new rate. The practitioner then explains any differences this rate change may yield and discusses other issues with management. For example:

- Can the client's customers bear the price increase?
- Are the new prices consistent with the marketplace?
- Is the client comfortable with the new rates?

Phase 4—Implementation

After the practitioner has analyzed the economics of the client organization and developed standard billing rates based on costs and target income, the client may still need additional assistance in modifying practices and procedures to implement the new pricing system. Typically, the original engagement will have a certain level of phase 4 implementation assistance. When significant revisions to the billing system are necessary or the client lacks the necessary expertise or would otherwise benefit from assistance, the practitioner can negotiate an extension of the original engagement or a separate agreement for additional implementation services.

Engagement Reporting

Progress Reports

Throughout the engagement, the practitioner may develop ideas and suggestions and should consider immediately communicating them to the client, orally or in writing. The end of each engagement phase is generally an appropriate time for such interim communication because the client's responses may affect succeeding engagement phases. The practitioner outlines all interim communications in the final report.

Final Report

The output in a service-pricing engagement is a written or oral report that recommends procedures to implement a pricing structure.[2] These recommendations may include the following:

- Establish standard billing rates.
- Reorganize the client's firm into profit centers or cost centers.
- Revise or develop a system to appropriately categorize costs and expenses.
- Monitor costs and expenses in order to periodically review pricing.
- Review and evaluate—
  1. Realized collections in relation to invoiced billings based on standard billing rates.
  2. Actual utilization rates in relation to expected utilization rates for staff members.

The report summarizes the information communicated during the engagement. It may also state that the practitioner can provide follow-up assistance in implementing and monitoring the recommendations. The practitioner may include other observations about the client's operations in the report or a separate letter. The practitioner needs to consider documenting the conclusions and recommendations, especially if the final report is not in writing.

Standard billing rates computed by using the formulas described in this practice aid are based on a targeted profit. Practitioners may not find it appropriate to recommend such rates to clients because the computed rates can be substantially higher than the client may be able to bill, considering the type of services provided, the amount of competition, and pricing norms. The practitioner's analysis of these broader pricing and profit considerations may lead to recommending strategic changes in the client's business. For example:

- Stop providing services that cannot be profitably priced.
- Add different services to realize higher billing rates and thus expand revenues.
- Establish practical compensation limits for professionals operating in certain specialties or locations.
- Develop marketing strategies to attract new clients.
- Reduce overhead and operating costs.
- Improve the utilization rate for professionals.
- Add professionals to reduce per capita overhead costs.

2. For information on engagement reporting, see SSMAS No. 2 and MAS Practice Administration Aid No. 1, *Developing an MAS Engagement Control Program* (New York: AICPA, 1982).

Conclusion

Service pricing is a critical aspect of a professional business. Even the most capable professionals can experience profitability problems if they price their services too low to generate sufficient revenue or too high to retain existing clients and attract new ones. Practitioners, as professionals themselves, are very familiar with service-pricing issues. They can assist clients by developing a pricing model and calculating a standard billing rate based on relevant factors, such as labor costs, expenses, overhead, and imputed owner's salary.

APPENDIX

Case Study: Developing Standard Billing Rates for a Law Firm

This case study illustrates how to develop standard billing rates. The process described will require modification to meet the needs of a particular client. The case study assumes that phases 1 and 2 (fact-finding and data analysis) have already been completed. It elaborates on the major steps suggested in phase 3 (conception and design) and does not discuss phase 4. The case study uses projected or budgeted data provided by the client, which is preferable to historical data. The practitioner, if also assisting with the preparation of the projected data, considers the requirements of the Statement on Standards for Accountants' Services on Prospective Financial Information, *Financial Forecasts and Projections*.

Background Information

The hypothetical law firm of Lee & Hager is a six-partner, single-office, general practice with fourteen associates and four paraprofessionals. If the firm were departmentalized, the practitioner would consider computing standard billing rates on a departmental basis. This would require allocating overhead among the departments on some rational, systematic basis. The cost of service of individuals working in more than one department would also require allocation. It is also appropriate to analyze the costs of service and utilization by staff category rather than on a person-by-person basis, as is done in this case study.

Methodology

Step 1

Determine the projected available billable hours (the law firm's "unit of production") for each individual in each category of activity. It may be an average for each professional group if the number of individuals in the group is large. Such items as base hours and projected overtime hours, vacation, holidays, sick leave, and professional education are calculated. Note that planned nonbillable hours are not separately analyzed in this case. This step is shown in exhibit 1.

Step 2

Determine the projected cost of service on the same basis as used in step 1 (by individual or category average). Include such items as base salary, bonus, overtime pay, retirement allowance, group insurance, and the actual or budgeted out-of-pocket cost of professional education (tuition, travel, per diem living expenses). See exhibit 2.

Step 3

Estimate total overhead costs, less amounts expected to be recovered from clients (billable expenses). Exhibit 3 illustrates step 3.

Step 4

Have the client provide information on the following critical factors (based on the client's expectations and experience):

- Utilization hours or rate, expressed either as the number of estimated billable hours or as a percentage of available billable hours (see exhibit 5)
- Realization rate, expressed as the ratio of projected collections to projected billings (for Lee and Hager, 83 percent)
- Target profit before taxes, after deduction of partners' imputed salaries (often based on the capital invested by the partners multiplied by a rate-of-return percentage, as shown in the numbers and calculations in exhibit 4)

Two scenarios are shown: The first assumes the desired income is $242,165 based on a 25-percent return on a $968,660 investment; the second assumes the desired income is $696,225 based on an 18-percent return on an investment of $3,867,917. The second scenario assumes that the partnership owns a building in which the firm's offices are located. Computer-based analysis would allow several different rate-of-return scenarios to be explored for each investment assumption.

Step 5

Calculate the following statistics, as shown in exhibit 5:

- *Cost of service per estimated billable hour.* Divide the total estimated cost of service for each individual by the total estimated billable hours for each individual.
- *Projected weighted overhead per estimated billable hour.* Divide the base salary for each individual by the total base salary for all personnel, and then multiply the resulting percentage by the estimated total net overhead to arrive at estimated overhead allocable to each individual. Divide the estimated overhead allocable to each individual by the estimated billable hours for each individual to arrive at overhead per billable hour for each individual. (This calculation may also be performed by staff classification.) As an alternative, divide the estimated total net overhead by the total base salary to arrive at an overhead charge per salary dollar. Then multiply this result by the base salary for an individual to arrive at overhead for that individual. Cost of service rather than base salary could have served as the allocation basis.

The cost recovery target is shown in exhibit 5 as the sum of cost of service and projected overhead per estimated billable hour. Exhibit 6 shows the next step: Add the cost recovery target to the income target, and then divide this sum by the realization rate to obtain a computed standard billing rate. This is shown for both income target scenarios.

- *Margin per estimated billable hour.* Use the base salary for each individual divided by the total base salary for all personnel, as calculated in the prior bulleted item, and multiply the result against the pretax target income (from exhibit 4) to arrive at the target profit per individual. Divide the target profit per individual by the estimated billable hours for each individual to arrive at income target (profit) per billable hour for each individual.
- *Computed standard billing rate.* For each person or staff classification, add the cost recovery target per estimated billable hour (which is the sum of the cost of

service per estimated billable hour and the projected overhead per estimated billable hour) and the income target per estimated billable hour, and then divide the sum by the projected realization rate to arrive at the new standard billing rate.

Using the data for partner E. Hager included in the Appendix as an example, the calculation of the standard billing rate would be as follows: Add the cost of service per estimated billable hour of $56.97 to the projected weighted overhead per estimated billable hour of $47.85. To this total of $104.82 add the income target per estimated billable hour of $27.76 (scenario 2) to arrive at the $132.58 target fee per estimated billable hour. Finally, divide the result of the previous calculation by Lee and Hager's projected realization rate of 83 percent* to arrive at E. Hager's computed standard billing rate of $159.73.

Partners differ on market demand for their expertise and on the life-style choices that determine the utilization they desire. In the example in exhibit 6, partner R. Lee has a computed standard billing rate of $266.20, which is 67 percent higher than that for E. Hager. This is a result of R. Lee's lower estimated billable hours.

Disparities in billing rates can result from partners having greater expertise or administrative and marketing time commitments. A practitioner may recommend that the client limit differences in standard billing rates between individuals within a given classification. Alternatively, the practitioner may revise the computation of standard billing rates to allocate that portion of the individual's administrative cost of service to estimated overhead. In this way the administrative or marketing costs are spread among others to avoid disparities in individual billing rates.

Other partner circumstances may result in a lower base salary (for example, a semiretired senior partner working a reduced number of hours) or a partner with higher expertise than average having a higher salary at full utilization or equal salary at reduced utilization. (R. Lee might be an example of the latter case.)

Step 6

Prepare a projected statement of income from operations as follows (see exhibit 7):

- Project gross fee income at standard billing rates by multiplying estimated billable hours for each individual by the respective standard billing rates.
- Multiply gross projected fee income at standard billing rates by the projected realization rate to arrive at net projected fee income.
- Subtract total estimated cost of service and total estimated overhead from net projected fee income to arrive at projected margin (profit) before taxes.

*This realization rate is for illustration only. The rate may be higher or lower for a specific professional services business. The assumed realization rate should be based on the firm's prior experience with realization until experience with a new billing structure suggests otherwise.

Exhibit 1

Projected Available Hours
Year Ending December 31, 19XX

	Base	*Overtime*	*Vacation*	*Holidays*	*Sick Leave*	*Professional Education*	*Available*
Partners							
E. Hager	2,088	150	160	80	40	40	1,918
R. Lee	2,088	50	160	80	40	40	1,818
J. Kinard	2,088	150	160	80	40	40	1,918
K. King	2,088	100	160	80	40	40	1,868
J. Foley	2,088	50	160	80	40	40	1,818
M. Kaplan	2,088	100	160	80	40	40	1,868
Total, partners	12,528	600	960	480	240	240	11,208
Senior associates							
D. Bryan	2,088	450	120	80	40	80	2,218
J. Cohen	2,088	325	120	80	40	128	2,045
R. Grant	2,088	300	80	80	40	80	2,108
K. Hilliard	2,088	275	160	80	40	80	2,003
M. Leone	2,088	200	120	80	40	64	1,984
D. Stone	2,088	250	120	80	40	48	2,050
Total, senior associates	12,528	1,800	720	480	240	480	12,408
Associates							
J. Abrams	2,088	250	80	80	40	80	2,058
L. Desmond	2,088	150	80	80	40	80	1,958
T. Grant	2,088	350	80	80	40	80	2,158
W. Morgan	2,088	400	80	80	40	80	2,208
P. O'Brian	2,088	275	80	80	40	80	2,083
L. Piccolo	2,088	300	80	80	40	80	2,108
V. Raeback	2,088	325	80	80	40	80	2,133
J. Smith	2,088	350	80	80	40	80	2,158
Total, associates	16,704	2,400	640	640	320	640	16,864
Paraprofessionals							
C. Bryan	2,088	200	80	80	40	40	2,048
N. Harris	2,088	300	80	80	40	40	2,148
J. Myers	2,088	150	80	80	40	40	1,998
M. Turillo	2,088	150	80	80	40	40	1,998
Total, paraprofessionals	8,352	800	320	320	160	160	8,192
Total, firm	50,112	5,600	2,640	1,920	960	1,520	48,672

Exhibit 2

Projected Cost of Service
Year Ending December 31, 19XX

	Base Salary*	Bonus	Overtime	Payroll Taxes*	Retirement	Group Insurance	Professional Education	Cost of Service
Partners								
E. Hager	$ 75,000	$ 0	$ 0	$ 3,100	$ 3,750	$ 2,400	$ 1,200	$ 85,450
R. Lee	75,000	0	0	3,100	3,750	2,400	1,200	85,450
J. Kinard	75,000	0	0	3,100	3,750	2,400	1,200	85,450
K. King	75,000	0	0	3,100	3,750	2,400	1,200	85,450
J. Foley	75,000	0	0	3,100	3,750	2,400	1,200	85,450
M. Kaplan	75,000	0	0	3,100	3,750	2,400	1,200	85,450
Total, partners	450,000	0	0	18,600	22,500	14,400	7,200	512,700
Senior associates								
D. Bryan	58,000	8,000	0	3,100	2,900	1,800	1,800	75,600
J. Cohen	57,500	8,000	0	3,100	2,875	1,800	3,000	76,275
R. Grant	64,400	9,500	0	3,100	3,220	1,800	1,800	83,820
K. Hilliard	59,800	9,000	0	3,100	2,990	1,800	1,800	78,490
M. Leone	61,600	10,500	0	3,100	3,080	1,800	1,400	81,480
D. Stone	58,700	9,000	0	3,100	2,935	1,800	1,000	76,535
Total, senior associates	360,000	54,000	0	18,600	18,000	10,800	10,800	472,200

Associates								
J. Abrams	44,000	5,500	0	3,100	2,200	1,800	1,800	58,400
L. Desmond	45,500	6,000	0	3,100	2,275	1,800	1,800	60,475
T. Grant	43,000	5,500	0	3,100	2,150	1,800	1,800	57,350
W. Morgan	49,500	7,000	0	3,100	2,475	1,800	1,800	65,675
P. O'Brian	41,000	5,000	0	3,100	2,050	1,800	1,800	54,750
L. Piccolo	43,500	5,500	0	3,100	2,175	1,800	1,800	57,875
V. Raeback	46,000	6,500	0	3,100	2,300	1,800	1,800	61,500
J. Smith	47,500	7,000	0	3,100	2,375	1,800	1,800	63,575
Total, associates	360,000	48,000	0	24,800	18,000	14,400	14,400	479,600
Paraprofessionals								
C. Bryan	20,000	2,000	2,000	2,000	1,000	1,200	800	29,000
N. Harris	20,500	2,000	3,000	2,075	1,025	1,200	800	30,600
J. Myers	22,000	2,000	1,500	2,075	1,100	1,200	800	30,675
M. Turillo	21,500	2,000	1,500	2,050	1,075	1,200	800	30,125
Total, paraprofessionals	84,000	8,000	8,000	8,200	4,200	4,800	3,200	120,400
Total, firm	$1,254,000	$110,000	$8,000	$70,200	$62,700	$44,400	$35,600	$1,584,900

*The partners' base salaries and payroll taxes are the same for purposes of illustration only. They are likely to vary in real situations.

Exhibit 3

Projected Overhead Expenses
Year Ending December 31, 19XX

	Gross Overhead	*Billable Expenses*	*Net Overhead*
Administrative payroll and fringe benefits	$ 282,000	$ 50,000	$ 232,000
Occupancy and maintenance	313,000		313,000
Equipment expense	104,000		104,000
Promotional expense	35,000		35,000
Entertainment of clients	75,000	40,000	35,000
Contributions	15,000		15,000
Insurance	38,000		38,000
Publications and library	43,000		43,000
Stationery, printing, and supplies	70,000		70,000
Postage	60,000	23,000	37,000
Taxes	10,000		10,000
Telephone	80,000	32,000	48,000
Travel	70,000	50,000	20,000
Firm meeting expense	20,000		20,000
Recruiting	15,000		15,000
Interest expense	24,000		24,000
Provision for doubtful accounts	69,000		69,000
Outside services	25,000		25,000
Miscellaneous	47,000		47,000
Total	$1,395,000	$195,000	$1,200,000

Exhibit 4

Calculation of Target Income
Year Ending December 31, 19XX

Scenario 1

Partners' investment (primarily for working capital)	$968,660
Target rate of return (based on investment, risk, and inflation)	25%
Target income	$242,165

Scenario 2

Partners' investment (for office building, furniture, and working capital)	$3,867,917
Target rate of return (based on investment, risk, and inflation)	18%
Target income	$696,225

Exhibit 5

Cost Recovery Target per Estimated Billable Hour
Year Ending December 31, 19XX

	Available Hours	Estimated Billable Hours	Utilization % Based on Available Hours	Cost of Service per Estimated Billable Hour	Projected Overhead per Estimated Billable Hour	Cost Recovery Target per Estimated Billable Hour
Partners						
E. Hager	1,918	1,500	78.2	$56.97	$47.85	$104.82
R. Lee	1,818	900	49.5	94.94	79.74	174.68
J. Kinard	1,918	1,600	83.4	53.41	44.86	98.27
K. King	1,868	1,400	74.9	61.04	51.26	112.30
J. Foley	1,818	1,100	60.5	77.68	65.25	142.93
M. Kaplan	1,868	1,300	69.6	65.73	55.21	120.94
Total, partners	11,208	7,800	69.6	65.73	55.21	120.94
Senior associates						
D. Bryan	2,218	1,900	85.7	39.79	29.21	69.00
J. Cohen	2,045	1,725	84.4	44.22	31.90	76.12
R. Grant	2,108	1,700	80.6	49.31	36.25	85.56
K. Hilliard	2,003	1,500	74.9	52.33	38.15	90.48
M. Leone	1,984	1,850	93.2	44.04	31.86	75.90
D. Stone	2,050	1,825	89.0	41.94	30.78	72.72
Total, senior associates	12,408	10,500	84.6	44.97	32.81	77.78

Associates						
J. Abrams	2,058	1,625	79.0	35.94	25.91	61.85
L. Desmond	1,958	1,500	76.6	40.32	29.03	69.35
T. Grant	2,158	1,700	78.8	33.74	24.20	57.94
W. Morgan	2,208	1,850	83.8	35.50	25.60	61.10
P. O'Brian	2,083	1,675	80.4	32.69	23.42	56.11
L. Piccolo	2,108	1,700	80.6	34.04	24.49	58.53
V. Raeback	2,133	1,650	77.4	37.27	26.68	63.95
J. Smith	2,158	1,700	78.8	37.40	26.74	64.14
Total, associates	16,864	13,400	79.5	35.79	25.71	61.50
Paraprofessionals						
C. Bryan	2,048	1,650	80.6	17.58	11.60	29.18
N. Harris	2,148	1,750	81.5	17.49	11.21	28.70
J. Myers	1,998	1,550	77.6	19.79	13.58	33.37
M. Turillo	1,998	1,650	82.6	18.26	12.47	30.73
Total, paraprofessionals	8,192	6,600	80.6	18.24	12.18	30.42
Total, firm	48,672	38,300	78.7	$41.38	$31.33	$72.71

Exhibit 6

Income Target per Estimated Billable Hour and Standard Billing Rate
Year Ending December 31, 19XX

Scenario 1

	*Cost Recovery Target per Estimated Billable Hour**	*Income Target per Estimated Billable Hour*	*Total Target per Estimated Billable Hour*	*Realization Rate (%)*	*Computed Standard Billing Rate*
Partners					
E. Hager	$104.82	$ 9.66	$114.48	83	$137.93
R. Lee	174.68	16.09	190.77	83	229.84
J. Kinard	98.27	9.05	107.32	83	129.30
K. King	112.30	10.35	122.65	83	147.77
J. Foley	142.93	13.17	156.10	83	188.07
M. Kaplan	120.94	11.14	132.08	83	159.13
Total, partners	120.94	11.14	132.08	83	159.13
Senior associates					
D. Bryan	69.00	5.90	74.90	83	90.24
J. Cohen	76.12	6.44	82.56	83	99.47
R. Grant	85.56	7.32	92.88	83	111.90
K. Hilliard	90.48	7.70	98.18	83	118.29
M. Leone	75.90	6.43	82.33	83	99.19
D. Stone	72.72	6.21	78.93	83	95.10
Total, senior associates	77.78	6.62	84.40	83	101.69
Associates					
J. Abrams	61.85	5.23	67.08	83	80.82
L. Desmond	69.35	5.86	75.21	83	90.61
T. Grant	57.94	4.88	62.82	83	75.69
W. Morgan	61.10	5.17	66.27	83	79.84
P. O'Brian	56.11	4.73	60.84	83	73.30
L. Piccolo	58.53	4.94	63.47	83	76.47
V. Raeback	63.95	5.38	69.33	83	83.53
J. Smith	64.14	5.40	69.54	83	83.78
Total, associates	61.50	5.19	66.69	83	80.35
Paraprofessionals					
C. Bryan	29.18	2.34	31.52	83	37.98
N. Harris	28.70	2.26	30.96	83	37.30
J. Myers	33.37	2.74	36.11	83	43.51
M. Turillo	30.73	2.52	33.25	83	40.06
Total, paraprofessionals	30.42	2.46	32.88	83	39.61
Total, firm	$ 72.71	$ 6.32	$ 79.03	83	$ 95.22

*From exhibit 5.

Scenario 2

	Cost Recovery Target per Estimated Billable Hour*	Income Target per Estimated Billable Hour	Total Target per Estimated Billable Hour	Realization Rate (%)	Computed Standard Billing Rate
Partners					
E. Hager	$104.82	$27.76	$132.58	83	$159.73
R. Lee	174.68	46.27	220.95	83	266.20
J. Kinard	98.27	26.03	124.30	83	149.76
K. King	112.30	29.74	142.04	83	171.13
J. Foley	142.93	37.85	180.78	83	217.81
M. Kaplan	120.94	32.03	152.97	83	184.30
Total, partners	120.94	32.03	152.97	83	184.30
Senior associates					
D. Bryan	69.00	16.95	85.95	83	103.55
J. Cohen	76.12	18.51	94.63	83	114.01
R. Grant	85.56	21.03	106.59	83	128.42
K. Hilliard	90.48	22.13	112.61	83	135.67
M. Leone	75.90	18.49	94.39	83	113.72
D. Stone	72.72	17.86	90.58	83	109.13
Total, senior associates	77.78	19.04	96.82	83	116.65
Associates					
J. Abrams	61.85	15.03	76.88	83	92.63
L. Desmond	69.35	16.84	86.19	83	103.84
T. Grant	57.94	14.04	71.98	83	86.72
W. Morgan	61.10	14.86	75.96	83	91.52
P. O'Brian	56.11	13.59	69.70	83	83.98
L. Piccolo	58.53	14.21	72.74	83	87.64
V. Raeback	63.95	15.48	79.43	83	95.70
J. Smith	64.14	15.51	79.65	83	95.96
Total, associates	61.50	14.92	76.42	83	92.07
Paraprofessionals					
C. Bryan	29.18	6.73	35.91	83	43.27
N. Harris	28.70	6.50	35.20	83	42.41
J. Myers	33.37	7.88	41.25	83	49.70
M. Turillo	30.73	7.23	37.96	83	45.73
Total, paraprofessionals	30.42	7.07	37.49	83	45.17
Total, firm	$ 72.71	$18.18	$ 90.89	83	$109.51

Exhibit 7

Projected Statement of Income From Operations
Year Ending December 31, 19XX

Scenario 1

Gross projected fee income at standard billing rates			$3,647,066	120.5%
Realization percentage			83.0%	
Net projected fee income			3,027,065	100.0%
Less:				
Projected cost of service (exhibit 2)	1,584,900	52.4%		
Projected overhead expenses (exhibit 3)	1,200,000	39.6%		
			2,784,900	92.0%
Projected pretax income			$242,165	8.0%

Scenario 2

Gross projected fee income at standard billing rates			$4,194,126	120.5%
Realization percentage			83.0%	
Net projected fee income			3,481,125	100.0%
Less:				
Projected cost of service (exhibit 2)	1,584,900	45.5%		
Projected overhead expenses (exhibit 3)	1,200,000	34.5%		
			2,784,900	80.0%
Projected pretax income			$696,225	20.0%

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