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Practicing CPA on firm management : a collection of articles from the AICPA local firms newsletter

Graham G. Goddard

The Practicing CPA

on FIRM MANAGEMENT

A Collection of Articles from the AICPA Local Firms Newsletter

AICPA
American Institute of Certified Public Accountants

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Edited by Graham G. Goddard

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FOREWORD

During the last several years, the practice of public accounting has changed almost beyond belief. Instead of a growth industry where small companies become large companies, we have seen large practices merge and even dissolve and many of these practitioners leave public accounting for industry and government. With these changes have come increased pressure on the smaller and medium-size firms to better manage their practices. Additionally, as a result of these changes, competition—with other accounting firms and with nonaccounting firms—continues to increase.

As clients become more knowledgeable, they become more demanding, and their long-term loyalty tends to diminish when traditional compliance services are offered. The nurturing of client relationships and the adoption of modern management techniques are essential if firms are to survive and prosper in the years ahead. *The Practicing CPA on Firm Management* will be a valuable resource in this regard.

The Practicing CPA was authorized by the AICPA board of directors in 1977, largely as a result of suggestions received from members attending local practitioner seminars and others who represented the interests of members in smaller CPA firms at the Institute. From the beginning, the focus of the publication has been on local firms.

Most of us in local practice appreciate *The Practicing CPA's* nuts-and-bolts type of material and easy-to-read style. Rarely is there an issue that does not contain at least one helpful idea for our individual practices. This has been particularly true during the last few years as changes in our local economics severely affected our clients and ourselves.

This collection of enlightening articles into one comprehensive volume will eliminate our search for past articles which we need to review in order to better run our practices. *The Practicing CPA on Firm Management* will be a valuable reference for all local firms.

—JAKE L. NETTERVILLE, CPA, Postlethwaite & Netterville, *Baton Rouge, Louisiana.*

WHAT'S INSIDE...

In November 1977, the AICPA commenced publication of a monthly letter for local practitioner members. *The Practicing CPA*, as it became titled, was to have a strongly practical orientation and a focus on such matters as practice management and the practical application of professional standards.

Articles on a variety of aspects of firm management have been a prominent feature of the publication over the years. Generally reflecting the experiences of successful local practitioners or the expertise of consultants to the profession, these articles contain a wealth of practical information.

Many practitioners have written to tell us they use *Practicing CPA* articles to stimulate discussion at partner retreats. Others find the articles valuable as reference when planning various firm programs. Requests for back issues of the publication are frequent.

A CPA firm can no longer assume its reputation assures prosperity or even survival. In today's highly competitive environment, firms must be well managed. This is where *The Practicing CPA on Firm Management* can help. This volume is a collection of firm management articles that have been published in *The Practicing CPA* from November 1977 through December 1990.

In order to increase the publication's usefulness, the articles are arranged into twelve chapters. Because some of the ideas expressed in an article often extend beyond one narrow topic and sometimes refer to articles in other chapters, or to other *Practicing CPA* material not included here, cross references have been retained where appropriate. Most of the articles have a byline. Those that don't were written by the editor. Brief synopses of the chapters follow.

Management Concepts
This chapter starts with the single-entity concept—the idea that a firm can only be managed properly if its needs are put before those of the individuals in the firm. The accounting profession is now experiencing the American free enterprise system, and other articles discuss zero defects and how to avoid starting out making mistakes, and what to do during an economic recession.

New and Small Firms
How can a sole practitioner compete with larger firms? This chapter has some answers. There are descriptions of practice continuation agreements and emergency assistance plans. In addition, the articles describe how to manage a profitable small office, how to select specialties, and how to survive.

All About Offices

Choosing a location for a new office and making decisions about space requirements is difficult. There are suggestions, here, on what to consider, how to establish priorities and conduct negotiations, through to the actual move-in and follow up. There are also ideas on establishing and running branch offices smoothly.

Planning

It is important to develop a long-range plan for firm growth and profit, and to have the partners meet, at least annually, to discuss the plan. This chapter covers the topics that should be discussed at the meeting, who should participate in the discussions, and the budget details and implementation of the plan.

Quality and Administrative Reviews

Quality reviews are now a factor in every practice. This chapter contains many of the articles *The Practicing CPA* has published on how to get ready for a quality review, selecting a firm to perform it, and on what an on-site review entails, amongst others. The benefits of administrative reviews are also discussed.

Fees and Billing

There are more articles in this chapter than in any of the other ones. They cover valuing your firm's services, time and billing systems and procedures, value billing, ways to turn casual conversations into billable events, and increasing realization by adopting procedures to prevent writedowns from standard. The last article deals with some of the changes due in billing and collection habits.

Chargeability and Productivity

There is a number of ideas, here, for increasing staff chargeability and for controlling chargeable time through a daily analysis of data. How to maintain, measure, and improve office productivity is also discussed.

Libraries and Research Facilities

Knowing where to obtain information quickly is essential if personnel is to be productive. This chapter has some ideas on organizing firm libraries to be cost effective and efficient.

Collections

How to improve the collection process, when to go beyond internal efforts, and what steps to take are covered in detail in this chapter. The secret of good accounts receivable management is to insist on being paid for work performed. These and other collection ideas are covered in this chapter.

Managing for Success
"Managing a CPA Firm Like a Business" and "Managing for Profit" are the titles of the first and second articles in this chapter. The need for strong leadership and good management information systems are cited. Other articles cover the need for standards against which to measure your performance, the need to control time—the item you are really selling—and the need for profit planning. The chapter concludes with articles on effective small firm management, and survival and success strategies.

Managing Growth
Rapid growth causes organizational problems. Growth must also be financed and managed. This chapter deals with the problems that arise and contains some ideas on optimizing the use of resources, and on ways practitioners can become better business people.

A Few More Ideas
Sometimes, seemingly simple ideas can make running a practice easier and add a few dollars to the bottom line. You will find in these articles a few thoughts on filing systems and cash management, and some reminders on ways to control malpractice costs.

Note of Thanks
The Practicing CPA has been well received by practitioners since its first issue in 1977. This is due to the people in all aspects of public practice who have been willing to share their ideas and experiences with their peers. There are too many to mention here, but you will find their names in nearly all the articles that have been reproduced in this volume. There are two people whose names don't appear in the text but without whom these articles could not have been compiled into a single source: Robert F. DiCorcia, who guided the book's production, and David K. Chipps, who designed the cover and pages.

We believe *The Practicing CPA on Firm Management* will provide an invaluable reference to which practitioners will turn again and again. We express our thanks to all who have contributed their time and talents.

—GRAHAM G. GODDARD, *Editor,* THE PRACTICING CPA, *AICPA, New York.*

Section 1

MANAGEMENT CONCEPTS

THE SINGLE-ENTITY CONCEPT

November 1980

Someone once described accountants as optimists with pessimistic tendencies. This may have been because the typical local practitioner is a person who takes great pride in his professionalism but who is also a very independent individual.

Perhaps because of these personality traits, the partners in many local firms are considered equals and above accountability to each other. As a result, the practice units are not run as single entities.

Certainly, the partners in firms such as these share bed and board, as it were, but in reality, each runs his own practice and the firm lacks common policies, procedures and goals. Often, there is no managing partner—no leader at all. Consequently, the firm is impossible to organize and is not really manageable. Lack of the single-entity concept is the foundation for problems in many local firms.

A single entity can only exist when the firm's needs are put before those of the individual. If there is no team spirit and teamwork, no understanding of or concern for others, if everyone is doing "his thing," has his own work, clients and employees, and if there is no review of work by others, conflict between partners is bound to arise to the detriment of clients, staff and firm alike.

Staff members become confused if they don't report to anyone in particular and if partners want their work done differently and have different philosophies. This makes it difficult to attract and keep good people. If clients belong to individual partners, service is adversely affected when the partner is away from the office.

Clients like personal service but they also want total service and continuity of service. (Total service implies that a client's problems in a given area will be handled by the most competent person the firm has in that area.) This does not mean that you cannot assign partners to a given client. We do in our firm. However, we also make sure that there is a second partner involved whom the client feels free to contact to get the answers he needs.

A firm operating as a single entity operates as a team. Because of this commonality, the firm is not only manageable but can be managed well and can benefit in several ways:

- ☐ Areas of responsibility and accountability are clearly defined and work can be adequately reviewed.
- ☐ Since there are firm-wide policies, procedures and standards, staff people can integrate their goals with those of the firm. It is then much easier to attract high-quality people to the firm.
- ☐ Partners work in closer harmony. Each has at least one specific area of firm-wide responsibility and is accountable to the firm for that area.
- ☐ The net result is better service to clients.

In general, there is a lack of awareness among some practitioners as to the advantages of the single-entity concept. To implement the idea in your firm, you will have to make it worthwhile to your partners. Let them see both the financial and the free-time rewards of the single-entity concept. You will have to appeal to their self-interest and persuade them to subordinate some of their personal needs and goals to those of the firm. Then, you must constantly assess the value to your partners of their practicing as a group to make sure that it really is worthwhile to them.

It isn't easy getting people to subordinate their needs and goals and to change their behavioral patterns, even for the apparent good of all. You will have to motivate them. Five things are necessary if you are to do this:

- ☐ Decide what behavioral pattern you want from each person.
- ☐ Then, reward the desired behavior every time it occurs. Communicate with people. Tell them they did a good job, etc.
- ☐ Gradually switch from always rewarding people to doing it less frequently.
- ☐ Ignore irrelevant behavior. Just bite your tongue and start over again.
- ☐ Fine-tune and shape their behavior into the exact form you want.

You may find that some of your partners can't be persuaded to embrace the concept. They may be strong-willed, self-reliant people who require an inordinate amount of independence. Some people just aren't compatible and should be sole practitioners. If you have a partner like this, consider a de-merger or dissolution. Remember though, your partners do not have to be carbon copies of each other to make the single-entity concept work. There is room for differences.

The secret to getting the single-entity concept working in your firm is organization. In this regard, it is essential to set up specific areas of firm-wide responsibility and make sure everyone has accountability. This can be done even in a sole proprietorship. The concept can be applied if staff is included in the planning process.

Whatever its size, your own firm is your best client, and everything you do should be directed toward its betterment and improvement. The challenge for local practitioners is to have an uncommon firm. The future is worth it.

—James B. Downey, CPA
Santa Fe, New Mexico

THE SHOEMAKER'S CHILDREN

November 1979

There are probably few CPAs in public practice who would question that the profession is in an era of rapid change, and that the flow of information from state and national organizations pertaining to new policies and procedures is moving at an unprecedented pace.

However, it is my contention that because of the time needed to keep up with this flow of data in order to be aware of new developments, as well as the time spent serving clients, practitioners in small practice units are neglecting their practices. After all, if one has only a certain amount of time to devote to one's work, the general belief is that it be spent improving client service rather than finding ways to run the practice more efficiently.

No doubt, many CPAs realize that it is essential for the well-being and long-range growth of a small practice unit that time be set aside to implement quality control procedures and improve its management. The question which may be raised is, how best to go about it? One can do it alone or, as many firms are doing, participate in the AICPA's local firm management review program. (In this program, a firm's operating procedures are evaluated by reviewers based on a checklist developed by the AICPA MAP committee.) Another alternative is to contract with an accounting firm consultant for guidance in the development and implementation of needed improvements.

In our complex society, specialists are needed to delve deeply into areas that require more time and greater expertise than can be supplied by a generalist. This is true of the medical field, and in our profession many firms have partners and staff people who specialize in complex areas. In small practice units, the practitioner must be much more than a specialist and must cope with problems involving personnel, billings, collections, timekeeping and library maintenance, etc. Usually, the added burdens mean time restraints on family life, sports and social activities.

Recognizing these problems, a new breed of practitioner has evolved—the accounting firm consultant who provides his clients with management expertise. Often, the consultant can, as an outsider, make suggestions and offer solutions that would otherwise be unacceptable to some partners or staff members.

Ideally, the consultant should be able to offer a broad background of experience in practice management, staff training and scheduling, and in reviewing workpapers and financial statements. Specifically, the following outlines require the most intensive review for a small practice unit and are areas in which a consultant can be of great help in developing cost-effective improvements.

Practice management.
- ☐ Personnel testing and hiring.
- ☐ Preparation of personnel manual.
- ☐ Timekeeping methodology, fee setting, billing and collection procedures.
- ☐ Leasing and/or purchasing of office equipment and facilities.
- ☐ Purchasing supplies (taking quality, price and the firm's image into consideration).
- ☐ Advertising philosophy—methods and layout.
- ☐ Professional and liability coverage.

Technical skills.
- ☐ Improving firm's policy manuals.
- ☐ Preparing quality control documents and implementing quality control procedures.
- ☐ Creating and using engagement letters.
- ☐ Creating workpaper formats for recurring engagements.
- ☐ Updating professional library materials.
- ☐ Implementing new policies and guidelines involved in compilation and review of unaudited financial statement engagements.
- ☐ Preparing financial statements and maintaining ledgers using a minicomputer or a service bureau.

Staff training and scheduling.
- ☐ Complying with state CPE requirements.
- ☐ Reviewing client problems and acquiring skills commensurate with clients' needs.
- ☐ Implementing in-house training courses, through the use of AICPA and other materials, in the most convenient method for the firm.
- ☐ Creating cost-effective scheduling methods.
- ☐ Maximizing partner's time. (Become a specialist or remain a generalist.)

Practitioners who are not convinced that improvement in the above areas will help them do a better job for their clients and improve the efficiency and profitability of a small practice unit might find an analogy in the fable of the shoemaker's children. The poor shoemaker spent all his time making shoes for his customers so that he was unable to make any for his own children. Ironically, they went barefoot!

– by Sheldon Ames, CPA
Cleveland Heights, Ohio.

BUILDING A FIRM THROUGH PARTICIPATORY MANAGEMENT

March 1981

As well as being concerned about our firm's financial success and about having a quality practice, we have, since its founding 13 years ago, been anxious that the firm enable our people to fulfill their personal goals. In our system of participatory management, our people's needs are used to strengthen the firm's management and generate beneficial results. The managerial talents of various people are matched with the jobs that have to be done and managers are given the greatest possible latitude in running their own operations. However, they must still stay within the confines of what the organization as a whole wishes to achieve.

An example of participatory management is the way we now conduct employee reviews. Previously, the managing partner, the team partner and the staff person attended the review which had to be rescheduled if any one of the three could not be there. As the firm grew, reviews became a large part of the managing partner's responsibility and we considered delegating the function to the personnel department. However, we knew that formal partner representation at reviews was essential to the success of the firm, and we decided that, because the managing partner's time was limited, another partner should be responsible.

We selected a partner who is interested in employee relations and who sincerely believes that reviews must be timely and fair and that written reports are required. While he does not schedule or conduct reviews or prepare reports, it is his responsibility to see that these things are done to the standards the firm has set. Employee morale has improved immensely since we started this system through appreciation of the resulting uniformity.

Here's another example. We sell our small-business clients management information systems (MIS), because we believe that with access to the same information that is available to their larger competitors they will run circles around them. We have taken our own advice and developed an internal management system which generates a wealth of useful reports on staff utilization, client profitability, billing, etc. There are several more reports, some of which are used only sporadically but which contain readily available information.

One of our partners, who believes in the value of management information systems and who realizes that they require continuous updating, has assumed the responsibility and authority to manage this activity for the firm. Again, he does not do the detail work but supervises the MIS and data-processing staff who produce the reports. It is his enthusiasm for the project, though, and his knowledge of the firm's goals and the resources available to attain them that have allowed us to grow to our present size without fear of over-expansion.

There are many other examples of our system as each partner who desires it is given a part in the management of the firm. This does not mean, however, that client service now takes a back seat. The quality of our accounting practice is still the primary concern of all our partners. It is just that managing our own firm receives the same consideration that we give our best clients. The firm benefits over and above the cost of a slight reduction in billable hours because partners are more creative. And the managing partner gains too from having more chargeable hours than normal and from being able to initiate activities.

We believe substantial benefits result from this type of management. For example, participatory management

- ☐ Gives a higher profile to the partners with management responsibilities. It reveals capabilities and makes evaluation easier.
- ☐ Provides managerial experience to a larger number of people and identifies future leaders.
- ☐ Makes the managing partner more dispensable.
- ☐ Develops comradery among partners.
- ☐ Makes initiating new activities and work more enjoyable.
- ☐ Allows the firm to grow (or slow down when necessary) by having the best people involved in its management.

For participatory management to work, the managing partner must make sure that managers' lines of responsibility don't overlap and that they have complete authority. Managers' responsibilities should be written down, detailed and made known to all who need to know.

It is essential that the managing partner create an atmosphere that encourages managers to take chances and be creative. Mistakes must be tolerated. The spontaneity that will develop must be nurtured, so the managing partner must anticipate and prevent problems, communicate with managers and give them the greatest possible freedom and credit for their achievements.

For their part, managers must be cognizant of the extent of their responsibilities and certain of their authority. They must also be fully committed to the idea—give it everything they have—and provide the managing partner with feedback.

How to start participatory management

First you should determine key areas where there must be a high performance level for success during the target period. These key-result areas come under three headings:

- ☐ *Personnel management.* Recruiting, communication, employee reviews and annual meetings.
- ☐ *Quality of practice.* Manuals, quality-control documents, accounting and auditing committees and filing system.
- ☐ *Financial.* Billings, collections, budget, accounts payable, financial statements, documents, annual partners' retreats, practice development and facilities management.

The ranking in importance of key-result areas will probably change from year to year. We set goals each year and while some areas where we wish to achieve good performance, such as billings and collections, are always selected, we do set our sights on new key-result areas. The major point is that we select areas which, if the firm is to achieve its goals, must be done exceptionally well.

Matching people with the responsibilities is a difficult and time-consuming job. Not only must the individual be capable of doing the work, but he or she must want it and have the time for it. Prospective managers must know their own likes and dislikes and be able to communicate effectively. Managing partners must be able to read between the lines, as it were, and should utilize outside consultants in the selection process if necessary.

There are several misconceptions about participatory management. For one thing, it is not permissive management and, for another, it does not have to be used all the time or in all situations. Probably the biggest misconceptions, though, are that participants have to do the detail work and all have to be granted the same amount of participation. They do not.

There are disadvantages too. Participatory management can give the impression that the managing partner is not in control and can infringe on chargeable time if not monitored. Above all, though, you can't rush it. It takes a long time to get the right person and the implementation can take several years on some tasks.

Nevertheless, we believe the advantages far outweigh any disadvantages. Our firm has experienced considerable growth since its founding and much of what has been accomplished can be traced to our system of participatory management.

–by Armin H. Nankin, CPA
Milwaukee, Wisconsin

AN OPPORTUNITY FOR BREAKAWAYS

January 1989

In many sports and games, such as cycling or basketball, a breakaway is a situation in which one participant breaks away from the pack and gets so far ahead of competitors that there is little likelihood of their catching up. The dynamics of our new professional environment offer similar breakaway opportunities to firms that can differentiate themselves, and pass by others that have grown complacent.

Many firms, in fact, are operating as though nothing is changing. They continue to maintain traditional work environments that encourage conformity over creativity, and promote risk aversion over risk taking. Both attitudes defeat any attempt to adapt to a changing environment.

In reality, the accounting profession is now experiencing what other business people have always experienced—the American free enterprise system. This is a system that basically has three rules: Communicate with your customers, reinvest a portion of your profits in research and development, and follow the first two rules or go out of business.

In the past, the accounting profession was effectively isolated from the free enterprise system. We could tell clients what the rules were without asking for feedback. We needed only elementary office supplies to start our firms. We could put all the profits, beyond what was needed to finance accounts receivable and payroll, into our pockets.

Today, we find ourselves doing client-needs analyses, sending clients questionnaires, and putting together focus groups to try to determine what clients want. Starting an accounting firm now requires expensive equipment, and a large percentage of revenue must be invested in training personnel, updating equipment, and in new services. Stricter standards, stricter enforcement of those standards, and unfettered competition encourage weak firms to fail.

The result of these changes is that the public and our clients now have more choices, better pricing, new services, and more attention paid to them by the profession than ever before. Nevertheless, while many CPA firms promote themselves as being able to help their clients survive in a highly competitive world, a considerable number of these firms experience difficulty in adapting to the changes. Often, the reason is a work environment that promotes one of the following maladies.

The "Tin God" complex

We are paid for our advice. The problem comes when we begin to take ourselves too seriously. We become "Tin Gods," experts in everything. The result is that we refuse to accept advice or consider new ideas or methods offered by others—the antithesis of what is necessary to be successful.

We are being told that we need to change and are offered suggestions. Because we are experts, though, we are unable to listen and to take advantage of opportunities.

The Pyramid syndrome

The typical accounting firm is organized like a pyramid. Each layer of personnel has a smaller layer above it. The upper layers review work, not for what is right, but for what is wrong, and send it back. Unfortunately, this approach to managing work is transferred to the way we treat people. In effect, we treat our staff like audits and tax returns—items to be reviewed and fixed.

The result is that we demotivate staff. Because of the constant threat of rebuke, people hesitate to offer suggestions that might help the firm.

The American buffalo affliction

When threatened, buffalo form into a tight, impenetrable circle for protection—impenetrable, that is, to threatening animals but not to the Winchester rifle. We tend to suffer from the same flaw. When under stress, we form a circle around a conference table. Many options are discussed, a few safe, unimaginative attempts at a solution may be made, but, for the most part, nothing substantial is done. The only real hope for many of us is that the threat goes away. That is not likely to happen anytime soon.

To survive, we are going to have to take some risks, and along with them, experience some failures. Perfection is not possible. With changes come opportunities, however, and if you decide to take advantage of them, you might find the following practice development suggestions helpful.

Ten things to do now:

- ☐ *Disband your marketing committee.* Consensus marketing leads to mediocrity and discouragement. Instead, create task forces to accomplish specific marketing projects.
- ☐ *Place a partner who is naturally inclined to marketing in charge of that function.* The person must be given the responsibility, authority, and sufficient resources to do the job. Anything less leads to frustration, failure, and, too often, the loss of the discouraged partner.
- ☐ *Have your baby boomer partners lead the effort.* They have the energy and incentive, are more open-minded to new ideas, and can relate better to their peers leading the new growth industries. Staff can help in creating client goodwill and in pointing out opportunities. Remember, though, that clients buy from partners, not staff.
- ☐ *Train personnel in human relations skills before giving them sales training.* Accounting services are intangibles and difficult to sell. It is easier to develop relationships that later lead to getting clients.
- ☐ *Put as much effort into retaining clients as into obtaining new ones.* Too many firms have to keep replacing clients lost because of inattention or poor service. It is important to keep "selling" present clients.
- ☐ *Don't try to reinvent the wheel.* There are numerous firms and consultants with the experience you are seeking who can help you avoid mistakes, reduce overall costs, and save time.
- ☐ *Don't copy what everyone else is doing in your marketplace.* Successful marketing comes from differentiation, not duplication. If your competitors are offering a new service, then it is often too late. You want to avoid being perceived as a "me too" firm. Either go in a new direction or offer enhancements to a service your competitors don't have.
- ☐ *Don't overemphasize your quality and underpromote your other attributes.* Clients have difficulty judging quality and tend to look for other attributes before making buying decisions. So, promote your attentiveness, care, responsiveness, and your innovativeness. And in today's market, it won't hurt to be perceived as aggressive, either.
- ☐ *Encourage and reward risk taking, creativity, and success.* You have to eliminate the belief that when someone in a firm is extremely successful, the role and stature of other firm members is diminished. Nothing is further from the truth. For any organization to be successful, it must have exceptional performances from its people. This can only be obtained through encouragement and reward.
- ☐ *Develop staff's skills, and reward improvement in the areas of management and practice development.* Reward systems based only on chargeable hours will result in an emphasis on only that. To see a dramatic improvement in management and practice development skills, try tying a portion of the bonus to improvement in these areas.

Although present conditions in our profession are creating considerable stress on practitioners, they are also creating numerous opportunities. Firms that are ready and willing to take advantage of these breakaway opportunities can position themselves for a rewarding future. ☑

—*by* **Timothy J. Beauchemin, CPA,** *Enterprise 2000, 1600 Smith, Suite 4250, Houston, Texas 77002, tel: (713) 951-7300*

NEW IDEAS FOR THE NEW AGE

July 1989

Firm brochures are scarcely a new idea, but Stonefield Josephson, a one-office "regional" CPA firm based in Los Angeles, recently provided one that takes a different approach to letting people know of its capabilities. The firm decided to present the information from the clients' perspective. In effect, to let some clients tell the story.

Stonefield Josephson considered several versions of its brochure before deciding to go with one featuring five successful business clients. Four of the clients had been with the CPA firm from their start-up years. All of them use most of the services offered and credit the firm for its contributions to their successes.

Joel S. Stonefield, managing partner, says the idea behind the selection of clients was to show the different industries the firm serves. The focus, though, is on its core, which is the apparel industry on the West Coast. Three of the five featured clients are apparel manufacturers, one of which has branched into real estate development. The other two are a consumer electronics import firm and a jewelry manufacturer and distributor. In describing their own businesses, the clients tell about the CPA services they use and how these services have helped them.

Another point that Stonefield Josephson wanted to make with the brochure is the firm's regionality. The firm has one office but covers the entire West Coast. The consumer electronics company, for example, is based in Seattle, Washington, a distance of over 1,000 miles from Los Angeles. The client says that distance is totally irrelevant to the effectiveness of their working relationship thanks to Stonefield Josephson's advanced computer network and the frequent use of FAX machines.

A third goal was to mention each partner by name somewhere in the brochure. Sometimes this is achieved in the comments of clients, or partners might be mentioned in the two-page description of the firm's services.

These two pages are the only ones devoted specifically to what the firm does. There are no photographs of staff sitting at conference tables, biographies of partners or, as Mr. Stonefield puts it, the inevitable picture of the pile of books in the tax library. Instead, there is near total reliance on client testimony on the firm and its staff.

Mr. Stonefield says that the firm wanted the brochure to project an image of what a group of bright accountants can do for people. At a cost to the firm of over $5 a copy, this was not a cheap undertaking. The firm made sure the paper, printing, design, and graphics (all client oriented) was of excellent quality. Stonefield Josephson printed 5,000 copies, which it estimates will be a sufficient amount for two years.

No dates are mentioned—except to say when firms were founded—and few specific references are made to time periods and financial figures. This should give the brochure a longer life. Updating or featuring new clients should be relatively easy, anyway, since the brochure is somewhat modular. There is a flap on the inside front cover to hold business cards and inserts, press releases, and flyers of interest to the recipients. The brochure is not usually sent to present clients, but to banks, lawyers, factoring companies, and other entities with whom Stonefield Josephson and its clients do business. Prospective clients, of course, are presented with the brochure upon meeting, if it is not mailed in advance.

Mr. Stonefield's signature appears on the first page at the end of a short piece about accounting in today's automated world. He explains how Stonefield Josephson has replaced green eyeshades with green screens—modern, computer-based tools and telecommunications systems that make accounting a continuous, current process.

Stonefield Josephson was founded about fifteen years ago. After about one month, the firm acquired its first word processor, followed a year later by its first computer. Today, about 150 clients are tied into a computer network which supplies their accounting needs on a time-share basis.

The network is extensive—all over the West Coast— and the firm, which gives heavy computer and accounting support, makes it almost a requirement that new clients become system users. The system allows staff to view clients' accounts at any time and to spot surfacing problems—all without leaving the office.

In fact, Mr. Stonefield thinks that the briefcase-toting accountant going to the clients' offices will be obsolete in the not-too-distant future. "With fiber-optic lines," he says, "we'll be able to obtain, via high-speed Fax, those clients' books and records not already on our system." The firm already markets a sophisticated merchandise management system with which clients—from start-up operations to companies with over 100 users—run their businesses. Ultimately, the firm expects most clients to turn to it as the provider for their information technology needs.

The development of an industry niche and its willingness to embrace new technology has boosted the firm's productivity. The average revenue per person at Stonefield Josephson is about $120,000 a year—perhaps twice the national average. Mr. Stonefield says that the high productivity results in large part from the ability of staff members using computer-based technology to produce high-value services at low cost. "For example," he says, "practically every corporate client has had created

An Old Idea for the New Age

Aggressive and progressive? Or too pushy for an accounting firm? Stonefield Josephson admits it took a chance last year in the way prospective clients might react to a billboard it used to advertise its accounting services.

The billboard shows a typical graph of business sales and profits. The problem depicted—skyrocketing sales and slumping profits—is one many entrepreneurial, fast-growing companies run into. These are the types of companies Stonefield Josephson likes to help, and whose attention it wanted to get.

The primary aim was to get media attention rather than clients directly. The campaign was successful in this respect. The firm was mentioned in the *Los Angeles Times*, the *Wall Street Journal*, and in several weekly business publications in the Los Angeles area.

The billboard campaign had another effect. Stonefield Josephson has already made a major investment in computerized management systems for apparel manufacturers and employs seven full-time staff members in this activity. The advertising campaign led Mr. Stonefield to much more personal involvement in public relations and in marketing the firm's computer systems—systems the firm can explain far better than anyone.

for it a highly complex, integrated operating projection, with virtually endless scenarios possible. These can be run in a few hours by a two-year staff accountant, instead of the several days of a partner's time, as in the past."

Further, most younger accountants at Stonefield Josephson have never had to manually create financial statements or adjusted trial balances. They don't have to. The computer does it for them.

"What is happening," says Mr. Stonefield, "is that whole new categories of services are being created that never existed before, or were available only for the largest clients. Our firm's high productivity is the result of our decision to move from pencil-pushing to business consulting."

Mr. Stonefield adds, "The technology orientation has totally changed the economics of our business. We have become capital-intensive and extremely entrepreneurial—just like our clients."

Computer technology is affecting all society though, not just the accounting profession. Whole industries exist today that would not be possible but for the computer and modern communications equipment. The credit card industry is one such example. The insurance, investment, and medical services industries are examples of others that have undergone dramatic change. As suppliers to major corporations, smaller companies have been in the forefront of these developments.

A futurist, as well as a CPA, Mr. Stonefield thinks that CPA firms that understand and intensively use computers and telecommunications tools are the ones that will survive and prosper. In his comments on the first page of the brochure, Mr. Stonefield says that the traditional role of accountants as purveyors of "yesterday's news" is out of place today. With modern tools, he believes, accounting is targeted on the bottom line yet, at the same time, focused on the *future*. ☑

ZERO DEFECTS—MANAGING ACCOUNTING FIRMS IN THE 1990s

May 1990

To survive and grow in the 1990s, accounting firms will need to be viewed as businesses as well as professional practices. Management skills will have to command more importance, and firms will need to adopt other modern business techniques.

For many practitioners, becoming a businessperson will require a change in attitude and methods. Better personnel management is essential if firms are to attract, train, retain, and motivate staff. Being more in tune with what the market wants and communicating that message to others is also necessary. Finally, becoming a businessperson will mean a willingness to take more calculated risks and to accept some failures in order to achieve successes.

To better understand the changes needed, let's first look at the current management philosophy at most firms. This philosophy is sometimes labeled "management by exception."

Management by exception is an outgrowth of the work of Frederick Taylor, as described in his book *Scientific Management*, written around the turn of the century. Mr. Taylor defined and analyzed the amount of time and the exact steps required to efficiently perform a series of manual operations. He then demonstrated that by arranging many different single operations along a line, sophisticated products could be produced. Managing the new mass production technology consisted of (1) identifying exceptions in the production line, (2) identifying those creating the exceptions, and (3) reprimanding them to obtain conformity.

Mass production was such a quantum leap over previous technology that many of its shortcomings were overlooked until the 1960s. These shortcomings include an atmosphere that dehumanizes the workplace because people are perceived as merely part of a process. Also, output tends toward average performance because of peer pressure on top producers to more closely match the performance of the group as a whole. In addition, higher-than-necessary error rates become acceptable.

In the early 1960s, the Martin Marrietta Corporation was charged with producing the new Pershing missile within a tight budget and limited time frame, and with high quality imperative. The company faced a dilemma, though, because the project director, James F. Halpin, believed that management by exception would not meet the goals of on time, on budget, and without defects.

The management system Mr. Halpin developed to meet these goals was a complete reversal of the traditional method and consisted of (1) focusing on preventing mistakes from happening, (2) identifying those who succeeded at preventing mistakes, and (3) positively reinforcing the successful behavior through praise and recognition.

Mr. Halpin combined this theory with several other concepts. He pushed more responsibility and the authority for taking remedial action down to the workers closest to the situation.

Everyone involved in production also had to meet the quality restraints. A deviation in one area meant compensating for it in another. Previously, each department was responsible for only its own output meeting certain quality parameters. This sometimes resulted in finished products that met departmental standards but were defective overall. The new procedure forced departments to work closely together. As a result of this new system, the missile was developed on time, had a minimum number of problems, and was significantly under budget.

The "Zero Defects" program, as it was named, was installed throughout Martin Marietta. The company experienced an almost thirty percent improvement in productivity and cost savings, and a significant increase in employee morale. The quality control department was abolished because problems were now solved where they occurred.

Although praised by the Defense Department and described in *Zero Defects*, which Mr. Halpin wrote in 1966, the concept was ignored by American industry and academia. It was picked up in Japan, however, and is being used to great effect. Today, U.S. industry is belatedly embracing the idea.

Installing a zero defects system in an accounting firm means accomplishing two things: It means getting closer to and more in tune with the client to avoid starting out making mistakes. It also requires restructuring the firm's management so that staff members can have more input regarding their task responsibilities, performance, and the ultimate quality of the finished product.

The key to getting closer to the client is the adoption of a good, firmwide, client-service system. One suggested method is described in my article, "The New Game—Client Service," in the January 1990 issue of the *Practicing CPA*.

Also key is placing capable, trained people in management positions. The right people in the right positions is central to the idea of zero defects.

The main obstacle for many firms in making this change is the legacy of the partnership way of doing business. This implies that all the owners are managers, and, thus, to manage the firm you must be an owner. Such a structure can deprive the firm of skilled management. Only a complete separation of the roles of ownership and management will allow a zero defects system to work.

In the corporate world, for example, owners usually are only entitled to a return on investment, to financial information, and to a vote on corporate issues. Management is given authority to realize corporate goals, and executives' financial rewards are based upon performance. The managers receive feedback on how they are doing, and have a defined structure in which to advance that is based upon their competency and the organization's need.

Many might argue that to allow non-CPAs to move into upper management and even control in an accounting firm would diminish the quality and integrity of the profession. Major engineering firms and hospitals, however, are professionally managed, yet only licensed, professional engineers can sign off on the safety of a bridge, and only licensed physicians can perform surgery or prescribe medication. The same should hold true for accounting firms in the future.

Imagine what could happen if accounting firms, in general, adopted these systems. Career possibilities would be expanded and staff morale increased. I believe, too, that as operations become more efficient and staff turnover reduced, quality would naturally improve, as it should in a well-managed firm.

To see the importance attached to these ideas in the corporate world, simply look at what is popular in the business management section of your local bookstore. Books such as *In Search of Excellence, Quality Is Free,* and *The One-Minute Manager* have all been on the best-seller lists.

The management philosophy in accounting firms today epitomizes the antiquated methodology of management by exception. I believe that the key to successfully managing accounting practices in the 1990s will be the adoption of the zero defects concept. Accounting firms must emulate Martin Marietta in the early 1960s and produce their services on time, on budget, and without errors. It's time accounting firms got on board. ☑

—by **Timothy J. Beauchemin, CPA,** *Enterprise 2000, 1500 Smith, Suite 4250, Houston, Texas 77002, tel. (713) 951-7300*

MODERN APPROACHES TO PRACTICE MANAGEMENT

May 1990

As have many other practitioners, the owners of our firm have been searching for a better way to function in a radically changing environment. We believe that a fundamental obstacle is the failure of accounting firms to practice in a businesslike manner. This is scarcely a new discovery. We think what is needed, however, is a new business philosophy.

Generally, what we hear at management conferences and seminars are suggestions for improving the systems already in place. The core problem for many of us is to develop a management system and corresponding structure which is successful in today's environment, and which will also build lasting value for tomorrow.

We have embarked on a goal of fundamentally revamping our firm operationally and philosophically. We have adopted a business philosophy based on modern approaches that is combined with a positive-reinforcement management style. And rather than concentrating solely on internal affairs, we have refocused our thinking to an external, market-oriented view.

To achieve our goals, we found we needed to

- ☐ Create a viable, long-term, strategic plan.
- ☐ Separate the goals of ownership and management.
- ☐ Reorganize personnel.
- ☐ Become closer to the market and our clients.
- ☐ Emphasize staff development.
- ☐ Change our pricing philosophy.
- ☐ Increase our research and development capabilities.

Creating a viable, long-term, strategic plan

We began the process by re-evaluating the type of firm we wanted. We had to decide whether we wanted to operate essentially as a group of independent, sole practitioners, or whether we wanted to build a viable, long-lasting organization. Our decision was to build a long-lasting firm that would operate without having all partners involved in every aspect.

As a first step, streamlining our practice enabled us to concentrate on what we could do profitably. This meant creating new performance measurements that were not based simply on charge hours or total income before partner salaries. (The first is a measurement of cost, not profit, and the second can be distorted by excessive time commitments.) In short, we are using profitability as our only measure and are being objective in how we determine it.

Another step was to reorganize the firm into separate components, even to the point of having some of these sections operate under different names. This is based on sound risk/return analysis. The hope is that a marketing strategy using brand names and images will enhance the overall value of the firm.

Separating the roles of ownership and management

The key principle is that firm managers have certain rights and responsibilities, as have the owners. It is important to separate these roles when dealing with many firm issues, though. In fact, we consider this another critical step. Prior to separating the two roles, we often lacked the discipline to follow through on some decisions because of the tendency for individual owners to act independently.

Now, the owners select the management team and establish overall goals for the firm once a year. Management has been given the responsibility and authority for achieving these goals. In addition, management positions are open to anyone with the necessary skills and motivation. This has resulted in less time being wasted by owners, more career opportunities for staff, and a general increase in morale.

Reorganizing personnel

Having decided to take a more corporate approach to management, we then found we lacked a proper organizational structure. Basically, what we had could be compared to a feudal system with nobles (partners) and peasants (everyone else), where the lower classes were constantly subject to the whims of the upper class.

This traditional method of managing an accounting practice is ineffective for two reasons. First, staff members are never sure who they really work for and often receive conflicting signals from different sources. Second, personnel is managed on an ad hoc basis without much consistency. Both situations lead to less than optimum performance.

Our solution was to create a structure organized along departmental lines that established clear lines of authority for hiring, training, promoting, and, when necessary, terminating staff. The title of partner has been eliminated. People in charge of departments are now called senior managers.

In fact, we are now organized as a typical corporation would be. We have sales and production departments, and an administrative division that handles all general functions. In addition, we have two technical departments for tax and information systems.

Personnel now have new titles. Directors are responsible for managing the different departments, and associates report to them. Consultants are technical specialists who work with the different directors and associates.

We find that the new structure has improved both the decision-making process and departmental productivity. In addition, we have identified career paths that are independent of ownership issues, and have thus eliminated the traditional up-or-out philosophy. Not becoming an owner no longer carries the stigma of second-class citizenship.

Becoming closer to the market

Being close to clients will be crucial to success in the 1990s, and we decided to put special emphasis on developing such relationships through three separate strategies. First, we established a firm advisory board comprising some of our best clients, referral sources, and prospects. The board's well-choreographed program helps us understand our clients' needs and expectations from their perspectives, and is instrumental in building close relationships.

Second, we have developed brochures, newsletters, and other marketing material for the same purpose—to build relationships. This contrasts with traditional sales techniques which are better suited to tangible products such as cars, which customers usually purchase infrequently.

The third strategy involves the installation of a formal client service system. This is designed to manage clients' perceptions of the firm and allows every member of the firm to serve clients better. It is derived from the zero defects method currently in vogue in industry, which has proved particularly successful in Japan.

The results achieved have been dramatic. Our bonds with referral sources and important clients have never been better, and we have gained many new clients that fit the mold we want.

Emphasizing staff development

We believe we need to provide more than just technical and professional training if our staff is to have the tools to meet new challenges. To this end, we have hired consultants to give presentations on goal-setting, communication skills, dress and appearance, and even social skills. In addition, we are scheduling management training courses for later this year.

As mentioned above, we are installing a client-service system. This will be a firmwide system because we want each department and the different staff levels within it to provide the same degree of service to each other that we provide to clients. Because the system incorporates the zero defects philosophy, we hope to see a marked improvement in operation efficiencies, as well as in working relationships. To a certain extent, this is already happening. People are becoming more image conscious and aware of the benefits of working as a unit. Staff morale is higher, as well.

Changing our pricing philosophy

Our new market-oriented focus forced us to look at our pricing policy. Improving operations can, in some instances, actually lower profits using traditional pricing methods. This is because pricing is basically cost-plus in our profession. We take labor costs, mark them up, add an overhead factor, multiply that by the number of hours spent, and charge the total to the client.

Under this system, the less efficient you are, the more money you can make because everything takes longer. A problem only occurs when your prices are higher than the value perceived by the client. You are then forced to write down the fee and may even lose money on the engagement. If you are particularly efficient, however, your fee may be less than the perceived value—again to your loss.

We are now pricing our services based on what the market will bear, wherever possible, rather than only on cost. This makes us look closely before accepting low-fee work and allows us to avoid short-changing ourselves on more valuable services.

There are two keys to making this pricing philosophy work. One is to use leverage, that is, to establish the price when *you* have the best bargaining position, not when the client does. An example might be to establish the price when a client urgently needs a service, rather than risk having the client challenge your costs when the urgency has been resolved.

The other key is to have your internal production and pricing system under control. In some of our segmented businesses we have introduced pay systems based on direct performance incentives.

Increasing our research and development capabilities

Increasing our ability to develop and offer new services in an affordable manner means changing still another tradition—that of trying to be completely self-reliant. Due to more competition and higher costs, this is no longer possible or desirable.

We have found we can reduce development costs through our membership in a network of firms. This enables us to share ideas and purchase all the materials we need to market a new service.

We are pleased with the results of these changes. We have made extensive use of consultants to help with management structuring and ownership issues. Network membership has expanded our product line and given us access to many educational programs, all at lower cost than if we had developed them ourselves.

Change has affected almost every aspect of our firm except one—our commitment to quality. In fact, we believe our new system has increased our ability to deliver quality services. Implementing the changes can mean much hard work, but it is worth the effort. We believe we are on track in becoming a successful firm of the future. ☑

—by **Kenneth C. Hugins, CPA,** *Cairns Hugins & Company, 1915 Aston Avenue, Carlsbad, California 92009-3914, tel.(619) 438-4000*

LEARNING FROM A LOCAL RECESSION

October 1990

The current economic climate should give reason for pause to any CPA firm wishing to be in practice at the beginning of the twenty-first century. Economic downturns present unique threats to the unwary and the inexperienced. On the other hand, learning from others' experiences can be invaluable in allowing one to escape similar circumstances. With that in mind, I offer the following thoughts and suggestions based on our experiences during the recession in the Houston, Texas, area during much of the 1980s.

The Houston recession came in two waves. The first, in 1982–1984, affected the industrial sector, particularly the independent companies in the oil industry. The second, in 1986–1988, affected the service sector, including banks and accounting firms.

A recession is more than just an economic slowdown. It reflects a fundamental restructuring of the entire local economy. This restructuring hits like an earthquake, and the "seismic shift" often includes a complete reordering of both the driving economic base and the community leaders who command that effort.

In Houston, many of the individuals who "ran" the city no longer have power today. Their businesses have gone into economic decline. During the same period, future power brokers were emerging along with the new industries they had developed. Compaq Computer Corporation and many other high-tech, medical, genetic, and aerospace companies that represent today's new power elite were unknown in 1982.

To emerge stronger in the recovery period after a recession, your firm must begin to shift away from the old industries and locate the new emerging ones as early as possible. To be successful, you must accomplish three goals: maintain your financial vitality, improve your organization's productivity, and refocus your marketing. Doing this in the negative atmosphere of a recession is difficult, and requires considerable intestinal fortitude. Let's look at some ways to achieve these goals.

Maintaining financial vitality

Your practice and client information is usually ninety days old. In other words, it generally takes about ninety days from the close of a financial period to get a real understanding of what happened during that period. Decisions made as a result of the information then take about another ninety days to show results. This means that 180 days may have elapsed from when the problem actually started until it is dealt with effectively. Unfortunately, few small businesses, including accounting firms, have the economic resources to survive 180 days without being dealt a fatal blow.

You can shortcut the process by immediately projecting the next ninety days on a worst-case basis, including billing and collecting. Take remedial action immediately, no matter how distasteful this may first appear. You will be thankful later that you did.

Managing cash. The first item that disappears in a recession is easy credit. Banks tighten up just when everybody needs money. The result is a liquidity crunch and stretched receivables. At the same time, the demand for your services may actually increase as companies in trouble seek the assistance and advice of CPAs in order to survive.

Unfortunately, many of these clients may not be able to pay you. You may have some difficult choices with regard to some long-time clients who need your help and to whom you feel obligated, but who cannot pay. Try to help them if you can, but don't let their going out of business take you with them.

Change your pricing system. I suggest you reexamine your pricing system because you will come under immense fee pressures during a recession. To succeed in such an environment, it is necessary to apply some of the sophisticated pricing techniques used in many industries. These include pricing leverage, that is, setting your fee at the most opportune moment, and using pricing psychology to assure timely payment.

Accountants are usually not trained in these two skills. They tend to establish price at the lowest point of leverage, and fail to lead their clients through successive stages of price resistance, then price anxiety, and, finally, payment resistance.

By using a pricing process that takes these factors, into consideration, you will find that write-downs can be substantially reduced and receivables kept in a healthier state.

Reduce inventory. Staying in business during a recession means properly allocating the firm's limited resources. In industry, the first step is to reduce inventory levels. Those companies failing to do this are usually among the first to go out of business. The same holds true for accounting firms. Here, inventory consists of people. The mistake made by many CPA firms is to maintain high staff levels and to cut back on investments in plant and equipment—the exact opposite of what is done in industry. CPA firms would do better to reduce staff and take steps to improve plant and equipment.

Improving productivity

Generally, all industries improve productivity during recessions. Companies within those industries that improve productivity the best, make the most money in the next expansion. In Houston, many companies adopted the "zero defects" management system. CPA firms too, might consider this program. (See the article, "Zero Defects—Managing Accounting Firms in the 1990s," in the May 1990 issue of the *Practicing CPA*.)

To practice accounting efficiently requires a highly-motivated, energetic staff. A zero defects program will both motivate staff for higher performance and provide the tools necessary to identify slack in the operation. In fact, the program works better in the service industry than in the manufacturing sector because of its dependence on human behavior rather than on automation.

Marketing

During recessions, many companies turn to marketing as a means of survival. Unfortunately, you cannot market your way out of a recession. This does not mean that you should abandon your marketing program, however. Instead, redirect and refocus it to where it will do the most good—that is in retaining the good clients you already have, and in identifying new, future-growth industries that will lead the recovery.

Retaining current clients during a recession is difficult. Due to the adverse economic conditions, they are more inclined to consider competing proposals on price alone. If you don't want to lose good clients, but don't want to lower your fees, either, you will have to offer them some other reasons to stay with your firm.

Clients tend to view their professional relationships in emotional terms. They are concerned with your reliability, responsiveness, assurance, empathy, and tangible attributes, and they take your technical expertise for granted. One of the ways to assure the same psychological response by every client is to adopt a programmed client service system. By this, I mean a formal method for managing clients' emotions as described in the article, "The New Game—Client Service," that was published in the January 1990 issue of the *Practicing CPA*.

Finding the new emerging businesses in your service area will require some innovation on your part. Because they are new companies, they will usually be unknown to you through your current referral network. To remedy a similar situation during the Houston recession, we appointed an advisory board consisting of both clients and nonclients, and developed some complex procedures to enable its members to help us locate and attract these types of clients.

We created procedures that included a well-orchestrated orientation program and a series of tight agendas for succeeding meetings. The results exceeded our expectations. The program is still in use today and still works as well as when it was started. Care must be taken in setting up such a program, however, to make sure presentations are appropriate and board members' time is not wasted. This is why we focused much of our effort on creating an implementation process.

In conclusion, remember that the seeds of success are often sown during recessions, at a time when a firm's talents and ability to work under pressure are challenged. This is the time, nevertheless, to position yourself for a brighter future. ☑

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Section 2

NEW AND SMALL FIRMS

IN SOLE PRACTICE

February 1986

Given the likelihood of continued changes in our professional environment over the next decade or so, particularly changes in clients' service needs and in the costs of providing those services, many people question the economic viability of being in practice alone. It is my contention, though, that there is a future for sole practitioners—that they can compete effectively with the larger accounting firms.

Prior to opening my own practice, I had worked for a large national firm; and for a small local firm with a staff of eight people. Then in 1975, I went into partnership with another CPA in Utica, New York, and we built the practice to a staff size of ten. In 1981, I opted to withdraw from the partnership and open a practice of my own in Oneida, New York, with one employee—a secretary/bookkeeper. There is now a second staff member—a receptionist/secretary who is heavily involved in the word processing functions.

There were several reasons that prompted me to become a sole practitioner. During my last year in partnership, I acted as the administrative partner, handling all of the administrative responsibilities for the practice, including our satellite office 25 miles to the east of Utica. In addition, I was also responsible for clients in Oneida, 30 miles to the west. The end result was that I was getting further and further away from actual hands-on accounting work and missed the one-on-one client contact. I did not have the control I wanted over product going out of the office and found my schedule increasingly structured by outside forces. I was also finding less correlation between my productive efforts and my rewards.

What are the odds of my survival over the next 30 years as a sole practitioner? I think they are good. The 1984 practice management survey conducted by the Texas Society of Certified Public Accountants shows that the sole practitioner form is more profitable than a partnership with up to $350,000 in annual revenues. The survey also breaks down sole practitioners' gross dollar volume for services rendered in different areas as follows: tax services, 40.7 percent, compilation and review services, 21.5 percent; thus, over 62 percent of revenue is from the less competitive, nonaudit areas.

I have found over the last ten years that the primary component of success in my practice is the stress on personal service. I believe that as long as I can maintain this type of attention and personal service to my clients, I can effectively compete with the larger firms.

When a company initially interviews a CPA firm regarding an engagement, the accountant sent to the interview may not be the person who later services the account. Disappointment over obtaining a noncomparable product, in the case of referrals, and philosophical and other misunderstandings that can arise because of this situation don't occur when the CPAs are sole practitioners, who must, of necessity, handle all aspects of an engagement. I believe that the continuity they can offer is an important factor in the decision many clients make to engage sole practitioners as their CPAs.

There are other reasons for being optimistic about the outlook for sole practitioners. Small businesses and professional firms frequently cannot afford in-house accountants to both maintain firm financial records and act as financial advisers to the owners. Therefore, the owners hire bookkeepers to maintain the records and engage outside public accounting firms to advise them. By nature of the size of their firms, the owners will gravitate to local CPA firms, which can provide them with personal service.

By stressing personal service, sole practitioners can also land engagements for those services that clients really want and in which fees are less of an issue, such as tax planning, accounting system design and consulting activities.

I find there is a growing demand for tax planning services because of the complexity and constantly changing nature of the tax laws. The alternative minimum tax, for example, has many confused. With my IBM PC and a tax planning package, however, I can rapidly calculate not only the alternative minimum tax but also the projected regular tax. I can then advise clients to pay state taxes in advance or to defer them, depending upon whether or not the alternative minimum tax kicks in. Being responsive to smaller clients' needs for this type of tax planning in my service area has enabled me to capture a significant part of the market.

Reasons for "going it alone"

Although each CPA who leaves a larger firm to open a practice alone is responding to a particular set of circumstances, there are several reasons why CPAs choose to leave larger firms and open solo practices, and some of these reasons show underlying strengths that bode well for the future of the sole practitioner.

Some people have individualistic personalities and simply don't fit in larger organizations or in employee or quasi-employee situations. Some CPAs also like to have total control over the quality of products and services and are not satisfied unless they do the job themselves. In addition, as a practice grows, a partner will inevitably have to give up some client contact because of administrative duties. Since client contact is for many of us one of the primary reasons for going into practice, its loss, plus the feeling of not serving clients with the attentiveness of the past, is another major reason why some of us leave larger firms to form solo practices.

Once established, compensation for the sole practitioner, according to the Texas survey noted above, can exceed that of peers in small partnerships with billings of less than $350,000 per year. So monetary reward can also be an important motivating factor.

Some people want to have offices in every major city in their state, others want to be the best CPA in their city. Some practitioners want plush offices, others are happy with lean and mean ones. Some CPAs have four children to educate, others have one. Such differences in outlook, desires and financial needs can cause dissatisfaction, prompt the dissolution of partnerships and be yet another reason for going into sole practice.

One definition of success

I think that underlying these reasons are strengths that we can use to help us compete as sole practitioners, but the single major asset we have is the real pleasure we find in our work. People who feel a loss of identity or of individual creativity will never be happy in their jobs, and the quality of their performances is bound to suffer. I believe that anyone wanting to attain a high level of performance or success must enjoy his or her occupation. As a sole practitioner, a CPA will never feel a loss of identity. Individual creativity will be greatly rewarded, too, not only in the monetary sense but also in the appreciation expressed by clients. One definition of success goes something like this: Find something that you really like to do, then find a way to make money doing it. For me, being a sole practitioner easily fits that definition. ☑

—by G. William Hatfield, CPA
Oneida, New York

IN SOLE PRACTICE (PART 2)

March 1986

A sole practitioner obviously cannot provide all of the services that large firms with multi-talented staffs can offer their clients. I can only deliver those services that I am qualified to complete. There are times when I am not able to fill every client need and must call upon outside help to fill the void. This entails the risk of losing the client, but there is also the risk of losing clients because their growth necessitates the use of a larger CPA firm. I still believe, however, that larger firms will be hard pressed to compete with the level of personal service I offer.

Marketing services

Marketing is now part of the way of life in many local CPA firms. Where experience is lacking, some insight into the techniques used by larger firms can be obtained by attending AICPA and state society marketing and management seminars.

One of the best ways to start is to determine what type of practice you have—what its philosophy is and what roles you and the firm play in your community. This will give you the basic background and tools to project where you want the firm to be in the future. You can then decide on your firm's financial and practice objectives and determine the best method of obtaining them.

For example, if you set a goal of increasing your billings from, let's say, $125,000 to $250,000, you must also determine how you will staff your practice and how you will handle the new business. If you plan on developing new services for current clients, you must decide how you will develop the level of expertise needed.

I divide marketing techniques into two categories—general and targeting. General techniques include involvement in community affairs, trade associations, chambers of commerce and Rotary clubs. I would also include the appearance of the office building and location, firm logo, stationery and equipment and personal dress. I believe that prospective clients consider these factors and am convinced that projecting a professional image makes a positive impression and is essential to a successful practice.

As a sole practitioner, I know my clients and their businesses well. I think of individual clients when I read articles on topics that affect them, and I phone them to discuss the implications. I use newsletters to inform clients of pertinent current events and write a monthly article on tax, financial planning and other related topics for a local newspaper. These are excellent communication devices. I also make a point of having lunch with clients and holding in-depth conversations with them to find out if I am in tune with their needs and if they are satisfied with the services I provide.

The targeting technique starts with the identification of specific prospective clients. The next step, of course, is to find out more about them—who the key people are, how they can be reached, which professional and business firms they use. Sometimes mutual acquaintances can arrange introductions, luncheons or social functions which can help in developing close relationships with prospects.

I believe that advertising is an expensive way for small accounting firms to obtain new business. The return on investment is minuscule. Far better to concentrate on developing new services for and referrals from current clients. Identification and retention of key clients who can contribute to the growth of the practice are essential activities.

Client newsletters and firm bulletins are ideal for informing clients of current tax developments and accounting changes that affect their businesses. Clients also want to know about such topics as pensions, collection of accounts receivable and finding sources of financing. I send my clients the AICPA's monthly *CPA Client Bulletin* ($135 a year for a minimum order of 50 copies) and frequently insert personal tax tips and financial planning ideas. The results are twofold. Client response often provides for additional billable hours and also generates topic ideas for seminars, which I find an excellent way for a small CPA firm to make itself known.

I try to hold annual client satisfaction meetings to find out what individual clients like best about me and my firm and how I can do a better job next year. Based on the responses, I can tell whether a referral request is in order or whether I am in danger of losing the client because of insufficient attention.

Filling the staff void

One drawback to being a sole practitioner is a shortage of professional help. I believe a sole practitioner must be able to render writeups at a competitive fee for clients that need those services. If not, the opportunity to provide more lucrative services may be lost. The only way to do this without consuming all the billable time is by using an in-house computer.

A number of my clients are professional corporations that have their own bookkeepers to maintain such records as the cash receipt, check disbursement and payroll journals. I recently acquired an IBM XT, on which I prepare general ledgers and monthly or quarterly financial statements for them. I also have an IBM PC, on which I do all of my payroll tax returns and compilation of data for printing W-2s at the end of the year. Last tax season, I processed all 1040s on it. Using the program "Word Perfect," I also find the machine to be an excellent word processor.

Another way to fill the staff void is through the team approach with other professional firms. My clients find it gives them more control over their businesses' financial and legal requirements when I, their legal counsel and pension administrators cooperate to service their needs. In the process, I develop a rapport with other professionals with whom I can exchange ideas and which can also lead to referrals.

On occasion, the firm with which I was affiliated in Utica renders services for me in areas in which I desire a second opinion, or for which I just do not have the time. In most cases, the fees for these services are billed directly to my client.

Client selection, retention and review

It is critical when developing a practice to obtain the proper client mix, that is, to obtain clients who will help you achieve your objectives and for whom you can provide a service. There are some clients I just don't want. They could be substandard in many ways. So at the first interview with a prospective client, I determine whether or not it is wise for me to accept the engagement. I must be comfortable with my clients and enjoy working with them, and they must use my services on a regular basis, be a profitable account and pay their bills on time.

I review my client list periodically to see if I need to weed out nonproductive accounts. Generally, though, if rapport has been established at the initial meeting and clients have been notified of what is expected of them as well as what they can expect from me, there is less confusion and misunderstanding over timely payment of bills.

Regardless of the size of the practice, its management's talents must be fine-tuned if it is to be successful. We CPAs graduate from college with all of the theoretical tools necessary to become employees in accounting firms. Unless we work in a practice where we are exposed to some aspects of running a firm, we will lack training in that area.

I believe that the management of an accounting practice conferences sponsored by the AICPA and state societies help to fill this void. The sessions cover such topics as computers, personnel, salaries, fees and firm profitability studies. It is, of course, also necessary to stay current with changes in tax laws and accounting and auditing standards. I exceed 40 hours per year in CPE. This is not a cheap undertaking, but the alternative is to be less competitive than other practitioners.

Once a month I interim-bill every hour spent on an engagement. Clients tend to pay smaller bills more quickly than larger ones, so if I complete a large engagement mid-month, I send out a bill then. This not only helps cash flow but is more acceptable to clients because they can better remember engagement specifics.

There will always be CPAs who want to be sole practitioners. To be successful, care must be taken in the selection of services to be offered, deciding where the highest profits are and the least competition is. And, of course, the stress must be on personal service. ☑

—by G. William Hatfield, CPA
Oneida, New York

WHY YOU NEED A PRACTICE CONTINUATION AGREEMENT

October 1989

In our practice, we have long subscribed to the theory that a firm's most important client should be the firm itself. In a small practice, and particularly in a sole proprietorship, it is all too easy to neglect our own affairs because we are busy taking care of clients and trying to generate practice revenue.

It is in our clients' and families' best interest, however, that we try to negotiate some type of buy/sell agreement that will allow our practices to continue in the event of our sudden disability or death. Where there is a partner who wants to protect his family's interests as well as those of the firm, drafting an agreement that is fair to all participants presents no significant problems.

This is not an easy task for many sole practitioners, who often have no one to turn to. In fact, this was the reason the Michigan Association of CPAs established a practice continuation plan. Population being sparse in many areas of the state, we saw a critical need to provide assistance to a disabled participant or to the estate of a deceased participant where no arrangements existed for the disposition of the participant's practice.

Participation is open to all members of the Michigan Association of CPAs and requires only a signed statement to that effect. In the event of an eligible member's death (without provision for the disposition of the practice), the assistance to practitioners committee offers its services to the estate representatives to help in the sale of the deceased's accounting practice so the spouse or heirs may obtain an economic benefit from it. In the event of disability, the committee offers assistance in providing services to clients, thereby preserving the practice.

Successor and servicing CPAs are selected in several different ways. A member may recommend up to six firms (sole proprietorships or multiple partner firms) as potential successors in the event of his

EXHIBIT 1

SUGGESTED LETTER TO CLIENT FROM DISABLED PRACTITIONER

(Disabled practitioner's letterhead)

(Name and address of Client)

Dear Client,

This will advise you that I have been taken ill (or hospitalized) and regret that I am unable to render my usual professional services to you at this time.

Until such time as I am able to resume my practice, ______________________, CPA, (address and phone number), has indicated his willingness to render professional services to you during my illness.

If these arrangements are satisfactory to you, please extend to him the confidence and courtesy granted me, and be assured of his wholehearted interest to serve you.

During this period, I extend my appreciation for your kind cooperation and look forward to resuming my service to you in the near future.

Sincerely yours,

or her death. If no recommendations were made, then one or more successors will be selected from those member firms that have expressed such an interest under the Association's plan.

Once the preliminary list of successors has been selected, the names are submitted to the estate representative(s) for approval. The list is then submitted to the deceased member's clients for their selection of a successor firm.

In the event of disability, the assistance to practitioners committee will provide a list of member firms that would be willing to provide client services until the disabled member recovers.

In the Michigan program, the sale price of a practice is based on 100 percent of last year's fees. (Fees are defined as accrual basis earnings excluding uncollectible items.) We receive many questions asking how we arrive at the figure. The answer, basically, is that it is the most representative price for the type of practice in the region. There are many considerations when trying to negotiate a sale price. A strong practice in a metropolitan area might derive more then 100 percent, for example, or if it is not a strong practice, it might derive less. In a sparsely populated region, however, where the nearest town might be fifty miles away, options are often limited, and we are comfortable with the 100 percent figure as a starting point.

The plan discusses the successor's paying 25 percent of the fees earned for a four-year period, but

EXHIBIT 2

LETTER FROM REPRESENTATIVE TO CLIENT

(Deceased participant's letterhead)

(Name and address of Client)

Dear Client,

As the Representative of the Estate of ______(decedent)______, CPA, deceased, I am writing to advise you that the Practice Continuation Plan Committee of the Michigan Association of Certified Public Accountants has offered its services to assist you, without any undue hardship or interruption to your requirements, in making arrangements for the continuation of the services formerly rendered by ______(decedent)______.

I am enclosing a list of the members of the Michigan Association of Certified Public Accountants who were personally selected by ______(decedent)______ during his lifetime and who have consented to continue ______(decedent)______'s work, with your consent. (I am sure that he exercised great care in the selection of his Successors and that he carefully selected those who would be most competent and reliable for your type of work.) Of course, there is no obligation to select any of the listed CPAs, but if you plan to engage in the services of a Certified Public Accountant, your choice of one of those on the attached list will facilitate the orderly disposition of the estate and provide you with continuing accounting services with a minimum of inconvenience to you.

Enclosed is a form which may be used to advise the Committee of your choice, and authorizing the estate to turn over to the person named by you, any of the applicable documents which the decedent had in his possession. Should you desire to personally interview any of the listed CPAs, please feel free to make your requests known on the enclosed forms.

Sincerely yours,

____

(Name of Representative) (Title)

with the total amount not exceeding 100 percent of the fees earned during the last twelve months of the practitioner's life. What, in effect, could happen if the client went to the successor CPA firm, is that the differences in billing rates and services provided might result in 100 percent of the prior year's fees being paid to the estate in, say, a two-and-a-half-year period. If this were so, payment would stop at that time and not be continued for the remainder of the four-year period for that client. This way, payment does not put a strain on the successor CPA, who might otherwise have to present full payment right away or work for nothing the first year.

The program's flexibility is, in fact, its strong point. If an eligible member of the Michigan Association dies suddenly without signing up for the program, his estate representatives can still contact the Association for help. Similarly, if the Association learns about the situation, it can contact family members to let them know the plan is available.

One interesting development since we began the program is that more sole practitioners have become aware of the need to work out a practice continuation agreement, and sometimes do so independently. In fact, the Association has not had to become involved in the disposition of any practice.

Although a clients' need for services may be less urgent at certain times of the year, practitioners realize that if they become disabled or die in the middle of January, clients are going to quickly find another CPA firm if they are not told promptly of other arrangements. Then, funds that could have been made from the sale of the practice are lost.

Michigan's is not the only state society-sponsored practice continuation program, although we don't believe there are many. It is not easy to establish a statewide program mainly because of the differences in the types of practices. Obviously, the best solution would be for all practitioners to sign agreements with someone whose practice they would be willing to purchase and to whom they would be comfortable selling their practice. A group of sole practitioners with similar firms could form an association, for example, and work out an arrangement that conforms to their needs.

Although the Michigan Association program has been in existence for over ten years, we still come across practitioners who don't know about it. We send a copy of the program to any member who asks, but there is no requirement to notify the Association on becoming a participant. We therefore really don't know how many members have actually signed up for the plan. Most participants keep a copy of the agreement with their wills and other papers, inform their estate administrators of its existence, and tell them to contact the Association for help in selling the practice.

All in all, we think the Michigan Association practice continuation program alleviates a major worry for sole practitioners, particularly those in rural areas, and provides ideas for the principals of other small firms who wish to make contingency plans. Our plan is popular with our members, and we offer encouragement to other groups of CPAs who would like to set up similar services. ☑

—by **Edwin D. Sitron, CPA,** *Sitron and Funke, CPAs, P.C., 2701 Troy Center Drive, Suite 105, Troy, Michigan 48084*

Editor's note: Mr Sitron is former chairman of the Michigan Association of CPAs management of an accounting practice committee. We are grateful to the Association for permission to reproduce the exhibits in this article.

AN EMERGENCY ASSISTANCE PLAN

September 1978

The death or disability of its principal can be devastating to a small firm unless ways can be found to continue the business.

Lee E. Schwartz of San Mateo, California, says that when, in the 1950s, a group of 25 CPAs (mostly individual practitioners) in the San Francisco peninsular area began meeting for breakfast once a month to discuss their problems, they found that the question of what to do in the event of the principal's absence was a major worry for them all.

They decided to do something about this and, in July 1962, adopted an emergency assistance plan to assure continuance of a member's practice in the event of his disability or death.

Mr. Schwartz says that the group now has grown to 59 members and although they are all still active, the passing years have made the original 25 members more appreciative than ever of the plan.

The group is still informal and operates in much the same way as it did over 20 years ago, although now a greater number usually attend the breakfast meetings.

A practice management questionnaire was developed early on, and this is circulated to members every few years.

Participants answer questions on a variety of topics such as gross billings, salaries and other financial data, vacation policies, office equipment, etc. The data are run through a computer and members can then compare their firms to an average.

The emergency assistance plan is presented for the benefit of other small groups of CPAs who would like to set up a similar service.

Peninsula C.P.A. Assoc.
Emergency Assistance Plan

Recognizing the need for a plan to maintain the operation and preserve the value of the practice of a member of Peninsula C.P.A. Assoc. in the event of incapacity, illness, accident or death, we, the undersigned, agree to act according to the rules stated below if called upon to act as a member of the standing committee or as agent.

The standing committee shall be composed of three members of the Peninsula C.P.A. Assoc. elected at a general meeting with a quorum of more than 50 percent of the organization's current mailing list. The committee is permanent. Also, the committee shall meet at least once annually to review and recommend changes in this memorandum to the group for action.

The duties of the standing committee shall be as follows:

1 Upon learning of the illness, accident or death of a member, they shall meet and call upon wife or send appropriate letter (exhibit A or B) to parties concerned. They shall determine availability of candidate to serve as agent. Elements to be taken into consideration in this appointment are:
   a) Availability of agent's time.
   b) Type of practice.
   c) Size of practice.
   d) Location of practitioner's office.
   e) Availability of practitioner's staff.
2 Upon receipt of letter of authorization from wife or practitioner (exhibit C or D), appoint agent.
3 Give close supervision to agent and meet with him at least monthly for purpose of reviewing action taken by agent.
4 In case of death, meet with widow and her advisors at the earliest possible time to discuss potential successor to the practice.
   a) Determine value of practice and present to widow.
   b) Determine best method of obtaining successor and present to widow.
   c) If authorized by widow, proceed to find, receive and refer to widow all offers for her decision.

Agent:
The agent shall direct and supervise the operation of the practice and

Exhibit A

Date__________

Dear Mr. and Mrs. __________:

It is with regret that we heard of Mr. __________ illness. We wish to remind you that the Peninsula C.P.A. Assoc. stands ready to act in your behalf to maintain the operation of his practice in accordance with our emergency plan, a copy of which you received and acknowledged on __________.

We cannot act without your written authority. We are attaching a sample letter which you may use for this purpose.

Very truly yours,

Exhibit B

Date__________

Dear Mrs. __________:

It is with regret that we heard of the death of your husband.

We wish to remind you that the Peninsula C.P.A. Assoc. stands ready to act in your behalf to maintain the value of his practice in accordance with our emergency plan, a copy of which you received and acknowledged on __________.

May we remind you that you cannot give us authority until you have received special letters of administration. To this end you should immediately contact your attorney.

We are enclosing a sample letter you may use after receiving the letters of administration referred to above.

Very truly yours,

Encl.

- ☐ Immediately upon appointment visit practitioner's office and advise staff of plan.
- ☐ No more than three days after receipt of letter of authorization from widow, he shall notify clients on practitioner's stationery (see sample letter).
- ☐ Shall then analyze time requirement to maintain practice and report the findings to the standing committee. The agent shall formulate a means to best maintain the practice which shall be submitted to the standing committee for acceptance.
- ☐ Shall continue to carry out plan approved by standing committee until released by action of the standing committee. A resignation will be accepted within two weeks by the standing committee within which time a successor agent will be appointed.
- ☐ Shall meet with the standing committee at least once each month.
- ☐ Shall respect internal procedures of practitioner, particularly with respect to billing of clients, collection of fees and preparation of checks for disbursement of funds.
- ☐ Shall compile records of time spent as agent. The agent's compensation shall be on following basis:
  - C.P.A. Not to exceed 80 percent of practitioner's hourly rates.
  - Other (agent's staff) Not to exceed 60 percent of practitioner's hourly rates.

  Should the practitioner not be a member, rates charged shall be at agent's prevailing rate for himself and staff.
- ☐ Shall have right to hire additional staff.

Exhibit C

Date__________

To the Peninsula C.P.A. Society:

Please be advised of the disabling illness of ________________.

I wish to authorize the Peninsula C.P.A. Assoc. to act in accordance with the emergency plan dated ____________.

Neither the association nor any individual in the society acting under the plan will have any legal responsibility or liability.

Very truly yours,

Exhibit D

Date__________

To The Peninsula C.P.A. Assoc.

Please be advised of the death of ____________________.

I have received special letters of administration from the court for purposes of managing and preserving his practice.

It is in this capacity that I hereby appoint you to act as my agent and to perform those duties specified in the emergency plan dated ______________.

Neither the group nor any individual in the society acting under your plan dated ____________________ will have any legal responsibility or liability.

Very truly yours,

Letter to Client

Date__________

Dear ____________:

It is/was the desire of Mr. ____________, your certified public accountant, that the service rendered to you be continued during his illness/after his death.

It was with this understanding that he authorized the Peninsula C.P.A. Assoc. to act on his behalf.

The standing committee of the Peninsula C.P.A. Assoc. has appointed Mr. __________ as its agent to assure that there will be no interruption in the accounting service rendered you. If any immediate problems arise, you can reach Mr. ____________ through the above number.

Agent

General
Neither the Peninsula C.P.A. Assoc. nor its appointee has any proprietary interest in the deceased practitioner's practice. The standing committee is always ready to act in an advisory capacity to the widow.

The standing committee or its agent shall do nothing to disturb the C.P.A.'s office as "the accounting office of the practice."

All signed reports shall be under practitioner's letterhead signed in his name by agent.

In the event agent does not carry malpractice insurance, he shall immediately apply for same. At the discretion of the standing committee, the premium may be charged to the practice being served.

PRACTICE MANAGEMENT GROUPS

January 1982

An article in the May/June issue of *CPA '81,* the journal of the Texas Society of Certified Public Accountants, that caught our attention was one about a resurgence of interest in practice management groups throughout Texas. Apparently, several new groups have been started and the practice management section of the Texas society's MAP committee is offering members help in their formation and continuation.

The idea is not new. The author of the article, John Beall, a Dallas practitioner, tells us he thinks practice management groups started in Texas in 1975 after a series of management conferences. He says that the first meeting involved relatively large firms in Texas, Arkansas and Oklahoma and that that group is still in existence.

Mr. Beall says that the practice management groups offer their members opportunities to discuss their mistakes and find out what is working for other firms. Some members find support both in the management of their practices and in the solution to technical problems. One group, apparently, has presented its own professional development courses, shared staff, developed its own audit manual and even loaned partners on occasion.

For a group to survive, Mr. Beall states that its members must have something in common, be it similar size, same type of practice and personnel, or even being confronted with similar problems. It is also very important that they are open with each other. He says that while it may seem difficult to start a group, basically only three things are needed. These are

- ☐ Individuals who are willing to share their experiences.
- ☐ A flexible but defined organization.
- ☐ Interesting program topics.

Mr. Beall explains that only a few organizational details are necessary, such as determining how many meetings will be held each year and selecting someone to publicize them. He says that one person should not be responsible for all of the programs—everyone should take a turn—and suggests that meetings are held at different members' offices with that particular member being responsible for the discussion topic.

Other points Mr. Beall stresses are that meetings be held regularly so that members can set the necessary time aside, and that they make a commitment to meet for at least one year so that the group develops unity.

The following are some suggested topics for discussion at practice management group meetings, MAP roundtables—even partners' conferences.

- ☐ *Billing and collecting*—techniques, establishing rates, wording a bill, age analysis, charging interest.
- ☐ *Budgeting*—how a little more time spent planning how to achieve goals can result in a lot less effort required to attain them.
- ☐ *Client relations and development*—expanding services to present clients, obtaining new clients through referrals, and promoting the firm through good client and community relations.
- ☐ *Compensation*—ways to divide the profits, how to keep good staff people in the firm.
- ☐ *Data processing*—applications, hardware and software considerations.
- ☐ *Filing*—procedures, what to keep, where to store, what to use and ways to file.
- ☐ *Financial matters*—cash requirements, accounts receivable, work in process, equipment financing, capital accounts.
- ☐ *Fringe benefits*—what is needed to attract and retain key employees.
- ☐ *Insurance*—professional liability coverage and limits, general liability and property insurance.
- ☐ *Long-range planning*—dimensions to consider, how to start.
- ☐ *Marketing and advertising*—deciding on the best techniques for your firm, selecting outside consultants, developing a plan.
- ☐ *Mergers*—advantages, disadvantages, pitfalls to watch for, the keys to successful mergers.
- ☐ *Office facilities*—selecting location, designing an office, negotiating a lease.
- ☐ *Partnership agreements*—evaluations and other problems, selection and admission,

termination, duties, voting, meetings, methods of compensation and retirement.

- ☐ *Peer review*—pros and cons, what is involved, who will do it.
- ☐ *Practice continuation*—dealing with death, incapacitation, helping the surviving spouse.
- ☐ *Manuals*—what you need, where to start, determining the value to the firm.
- ☐ *Recruiting*—how and where to do it, how to evaluate candidates, deciding on the level of commitment.
- ☐ *Staff evaluation*—the reasons for a formal program, methods to use, finding out if a program is cost-effective and has positive results.
- ☐ *Staff motivation*—understanding the influencing factors and basic psychological principles.
- ☐ *Staff scheduling*—methods used, how far ahead to schedule, who to put in charge, resolving conflicts.
- ☐ *Staff training*—planning programs; techniques; on-the-job, in-house and outside programs.
- ☐ *Time reporting and control*—evaluation of billable and nonbillable time, methods of keeping time, managing staff and personal time.
- ☐ *Valuing a practice*—for purposes of sale to another firm, admitting another partner, etc.

There are, of course, many other topics suitable for discussion at such meetings. Practitioners will find more ideas and some suggested meeting procedures and objectives in the AICPA *MAP Roundtable Discussion Manual.* Contact Jim Flynn at the AICPA (212) 575-6439 for further information.

THE ADVANTAGES OF SMALL ACCOUNTING FIRMS

March 1987

Recent years have seen the mergers of many accounting firms, and the issue of small firm/large firm advantages has become increasingly pertinent to CPAs and the public that uses their services. It is a subject that I, as a small practitioner, discussed many times with other CPAs from both small and large firms, and with educators, students, and other interested parties.

As part of the research for my doctoral dissertation, I conducted a study for developing criteria in establishing a new accounting practice. I wanted to find out what advantages small accounting firms believed they held over large ones. I also wanted to know what they thought large accounting firms could provide clients that they could not. I anticipated that these opinions might be of help to prospective practitioners in determining what to emphasize in their operations in order to attract clients.

Prior to conducting this study, I searched the literature for articles on small-firm advantages but found none. I did find some articles in the June 1974 *Journal of Accountancy*, however, that discussed the advantages that large firms held over small accounting firms.

The apparent advantages, according to Jesse T. Barfield, "Small Firm Specialization: Why and How?," and Thomas D. Wood, "How Small Firm Practitioners Can Avoid Substandard Audits," are that large firms can more easily

- ☐ Implement the team approach, using both specialists and generalists, on an intrafirm basis.
- ☐ Afford specialists and administrative personnel.
- ☐ Conduct audits through an ability to allocate the necessary time and personnel, and handle logistical problems.

Various suggestions have been offered to help small firms overcome these perceived disadvantages. One possibility is for small firms to offer specialized services or to concentrate on particular industries rather than providing general services. Another idea is for small firms to minimize the effects of their lack of specialists and administrative personnel by developing the structure necessary for successfully providing basic services.

To obtain the opinions I wanted, I sent questionnaires to 350 small practitioners located in seven southeastern states and interviewed forty others in four southeastern states. One hundred and eighty-eight practitioners responded, offering these advantages they believe they have over larger CPA firms: more personal contact, 92 percent; lower fees, 32 percent; quicker service, 32 percent; more courteous service, 20 percent.

A majority of the small practitioners agree that large firms can usually offer a greater variety of services and more specialized ones than they can, and that these are important considerations. None of the respondents said that large firms charge lower fees or provide quicker service, however.

A few small firms think that prestige, the ability to service very large clients and conduct audits for SEC registrants; and their wealth of experience in highly unusual situations and greater use of computers might give large firms advantages. Several small practitioners believe that large CPA firms have no advantage over small ones at all, though.

Many say they can provide more efficient service than larger firms can and are more willing to service small clients. Some think they can offer more productive management services and more individualized service, and many believe they have better communication with their clients. The small practitioners say that their close, personal relationships with clients result in more concern for clients' welfare and permit a deeper insight into their financial and tax situations.

Many of those interviewed expressed strong feelings concerning the types of services that small CPA firms could provide more effectively than large ones. They believe they can offer continuity and a more complete, better-quality service, with the added attraction of being able to render special services on the spur of the moment. ☑

—by Jack R. Fay, CPA, Ph.D.
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MANAGING A PROFITABLE SMALL OFFICE

February 1981

As a general rule, one aim of a small practice is to increase chargeable time in service areas that command the highest fees and, conversely, to decrease time spent performing services that cannot result in reasonable fees. However, this is idealistic and intentions must be viewed in light of what is attainable and practical under the circumstances.

For example, it is often difficult for someone just starting out in practice to turn down any business. Some practitioners, in fact, advise never turning away a client merely because a small fee is involved. On the other hand, it is hard to rid one's practice of unprofitable or undesirable accounts once they are entrenched. Perhaps the best advice to practitioners is to be as selective as possible before undertaking any engagement.

Some services offer a lot of scope to a small practice and can be quite remunerative. Tax consulting, planning and reporting; estate and trust planning and reporting; management advisory services; and the rendering of opinion audits and reviews fall into this category and are some of the areas where practitioners should direct their time.

Usually, the least remunerative engagements for general practitioners are bookkeeping services, unaudited reports and the preparation of individual off-the-street tax returns. If you find it necessary to perform services that don't pay very well, try to select those that will lead to better engagements later on.

For a small office, a profitable fee structure is a must. Very often though, the fixed-fee method is employed—i.e., the client is billed at a pre-determined and agreed on amount for the completed engagement. This method may be unavoidable if a bidding requirement is attached to the engagement but it is usually the least desirable way from the viewpoint of profitability. For one thing, it is difficult to accurately estimate time requirements and thus obtain a reasonable fee for one's efforts. Also, new practitioners tend to underestimate the time needed—partly through relative inexperience and partly because they are anxious to get the engagement.

The engagement letter should stipulate the exact limits of the engagement and state the fees agreed on for any extra work that is necessary. This way, any loss encountered will be confined to the basic bid and not extended to extra work.

Finally, repeat work should never be accepted at the same fixed fee unless time records show the prior engagement was profitable. Usually, the only people who benefit from fixed-fee engagements are the clients. They drive hard bargains.

A far better way of determining fees is by the hourly-rate method in which the client is billed for the hours of chargeable time devoted to the engagement. This results in a reasonable cost to the client for services received and a reasonable return to the CPA for the professional risks undertaken. (The time records should classify type of work performed.)

Here are some suggested methods for setting hourly rates:

- ☐ Two and one-half to three times the total annual salary of junior and senior staff and of partners divided by normal chargeable hours.

  For CPAs, this is based on what you think you are worth (you can get some ideas on this from the "Practice Management Profile" in the June 1980 issue) and 50 percent productivity. The normal productivity rate for staff members is 75 percent.
- ☐ Three times the hourly base salary-rate disregarding productivity. This is a shot in the dark approach but has worked very well.
- ☐ Per diem rate of 1 percent of annual salary for staff members and of desired worth for CPAs.
- ☐ Arbitrary rates, not cost related.

The goal should always be to charge the maximum for all hours worked. The rates must be flexible, though. Salary increases should automatically trigger increases in the basic rate if raises are not to reduce the firm's profitability.

For audit engagements, the rates should be based on the level of work performed. For tax consultation, research, return preparation and examinations the rate applied should be doubled. There are very few repeat engagements for management advisory services, so the basic rate on one-shot engagements should carry a premium.

In any practice, but particularly in smaller ones, the control of operating expenses is paramount. Here are a few ideas on the subject.

Staff salaries should be determined by local conditions with the total amount not exceeding 25 percent of gross income. The number of people employed should be adequate to handle the normal volume of engagement hours. However, you must utilize people's services fully and offer them advancement or they will leave. You might consider using part-time staff, such as college students, professors, housewives and retirees, where applicable. Give staff the best—good fringe benefits such as hospitalization and life insurance, progressive vacation days and adequate sick leave are a must.

Office space must be adequate (about 293 square feet per person) and should not cost more than 5 percent of gross income. A prestigious location is not thought necessary any more, but the office should be attractive to clients and pleasant and efficient to work in.

Tax and other subscription services should not cost more than 2 percent of gross income. Nevertheless, they are good investments, so get the best, and renew early if it lowers the cost.

Professional dues and development courses should account for about 2 percent of gross income. You should belong to most professional accounting organizations in order to improve your knowledge and ability, and you should take those CPE courses that will do you the most good. Decide what is best for you and your clients.

Client promotions should usually run to about 3 percent of gross income but could go up to 5 percent. The trick is to be neither a tight wad nor a reckless spender with entertainment. Remember, really secure business ties result from close relationships with clients and their families.

Office supplies should cost about 5 percent of gross income. Don't send someone out to buy one or two accounting forms when you need them. Buy standard forms in quantity from suppliers, instead. And avoid printing your own forms — it's too costly. Use your copying machine.

Equipment costs should not amount to more than 2 percent of gross income. However, don't let the office become run-down. Be a model for your clients. Make sure your office equipment and furniture are up-to-date. Another point: equipment maintenance contracts are costly and in most cases should be avoided.

Travel expenses should come to about 2 percent of gross income. An auto can be used for limited journeys. If the distance is over 500 miles, fly.

Insurance should cost about 2 percent of gross income. You must have adequate insurance but that does not mean it has to be the most costly. So shop around for the best rates on valuable papers, equipment and auto coverage. Another must is professional liability insurance — you can be sued. Check out the AICPA plans.

–by Fred A. Schwarz, CPA
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GROWTH AND PROFIT THROUGH SPECIALIZATION

March 1989

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

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

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

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

Selecting a specialty

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

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

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

Remaining a small firm

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

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

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

How to specialize

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

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

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

How to promote your specialty

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

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

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

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

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

When to specialize

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

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

The benefits of specialization

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

Our client retention is also much better. We seldom have client turnover except for those who are going out of business or are leaving town. We are working with nicer clients, too. That makes our work more enjoyable.

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

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

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

SUCCESS THROUGH A LIMITED-SERVICE PHILOSOPHY

June 1989

Ours is a small, limited service, one-office CPA firm. We have evolved into what we are because of failing in our attempt to become "The largest CPA firm in the free world!" We are finding success, however, through a limited-service philosophy and would like to share our experience.

Our firm is located in an area of about 125,000 people who are heavily dependent on agriculture and oil and gas industries, and on small businesses. There are no national firms in town, although they do serve the area. There are seven people in our firm—four accountants, one administrator, and two computer operators. Three of these people are part-time outside tax season.

We have chosen not to be a traditional full-service CPA firm. Typically, such a firm finds that greater than 50 percent of its revenue comes from what I call "looking back" services. These consist of audits, reviews, compilations, accounting, and tax compliance—services most accountants are comfortable providing and which, generally, can be depended on year after year.

I believe it is difficult for small firms to offer all of the traditional services. The explosion of information, standards overload, the constant competition for staff, peer and quality review requirements and costs, liability issues, and fee competition were all factors in our decision not to offer the full range of services.

There is a distinction, I believe, between a limited-service CPA firm, which is what we have chosen to become, and a firm that specializes by industry. (See "Growth and Profit Through Specialization" in the March 1989 issue, page 1.) We don't specialize in our firm but have limited our services to exclude audits and reviews. We emphasize what we do best. The following strategies form the foundation of our philosophy:

Get out of auditing and reviews (or get in them in a big way). The relationships and services we attempt to develop and provide keep us from being independent. Our compilation reports so indicate, and we have experienced no adverse effects. In fact, the opposite has occurred. We find that when you no longer have to be independent, you become valuable to your client.

We prefer to refer the audits and the liability to others, and keep the good work and the premium fees. Our largest client, for example, is the audit and tax compliance client of a national CPA firm. We think this strategy keeps clients from outgrowing us.

There are certainly other firms, besides national firms, which are capable of performing audits. We refer to national firms, though, because we think there is less risk of our losing the client. National firms, by their very nature, cannot provide the services we can. In fact, they have referred to us other services we are capable of providing.

In addition, by not performing audits, our firm is required to undergo a report review rather than have an on-site peer review. This results in a cost savings.

Many firms attempt to justify keeping a couple of audits they have been doing for years. To me, that is like a family-practice doctor performing a couple of open-heart surgeries a year!

Provide services which build solid client relationships. Clients want someone to listen to them—a financial friend. In fact, clients want a financial psychiatrist. Someone to become financially "naked" with and not be laughed at. This takes a relationship built over years, a relationship that most CPAs serving small clients already have.

We are not ashamed to provide nonglamorous, profitable services such as write-up, payroll check-writing, depreciation/amortization schedules, sales/payroll tax returns, and other services within our capabilites. We have to have a base of compliance work from which to generate "looking forward" services .

Develop expertise and provide services that involve the future. We all tend to become comfortable providing the reliable, traditional services and hesitate to let go of them in order to develop services we are not sure will reoccur. In a limited service practice, about 50 percent of what is being worked on now had not happened a year ago, and 50 percent of what will be worked on next year has not happened yet.

We have found that these types of services are much less fee sensitive than traditional services. Many of us in local practice could increase our gross fees 30 percent without adding a new client, if only we would.

Get rid of your employees. The use of the word "employee" creates a class system that we think is undesirable. Instead, we use the term "associate."

Limit firm growth. Uncontrolled growth is deadly. We think that growth exceeding 15 percent per year in billable hours is a disaster waiting to happen.

We also try to avoid having one client group contribute more than 10 percent of our firm's revenue. We prefer to be in control of our financial destiny.

We believe that net profit rather than gross fees is the measure of financial success. In fact, we have experienced an increase in the bottom line with a decrease in gross fees.

Develop relationships with tax lawyers. They are great referral sources for "looking forward" services. (CPAs are tax lawyers' greatest source of referrals, too.) Tax lawyers know which firms are best at what and make referrals accordingly.

These relationships can also save tax-library investment dollars. We have a limited tax library. We found that we spent too much time attempting to research problems and were not sure of our answers. Now, we call our tax lawyer friends who have the research tools and know how to use them.

Become computer proficient. This means knowing how to use both hardware and software. We believe microcomputers are tools, and that everyone should have one. We never asked people to share pencils and adding machines. Accordingly, every person in our firm has a microcomputer and printer.

Having the hardware and software at your fingertips is one thing. Knowing how to use them efficiently is another. We made a critical mistake here.

Our mistake was to view computers *only* as tools, not to be understood but to be used to practice accounting. My philosophy about computers was similar to my philosophy about automobiles—I don't care how and why they work, I just want them to run when I turn the ignition. This has kept me from being able to solve the simplest of auto problems, denied me transportation, and cost me a lot of money. A similar philosophy about computers has made us dependent on others, denied us the use of our tools, and cost us a lot of money.

Our goal for 1989 is to provide our personnel with the tools—a centralized, standardized software and applications library, homogeneous equipment, and the skills to increase individual and team productivity in order to more efficiently prepare better products for our clients. We will create an atmosphere of "We can and we will" understand enough microcomputer technology to function on our own.

Some "Looking Forward" Services

- ☐ Forecasts and projections
- ☐ Cash flow studies
- ☐ Budgeting
- ☐ Personal financial statements
- ☐ Business and personal financial planning
- ☐ Debt restructure/workout projections
- ☐ Litigation support
- ☐ Marital/property settlement disputes
- ☐ Investment projections
- ☐ Retirement/social security planning
- ☐ Education planning
- ☐ Estate planning
- ☐ Income tax planning
- ☐ Management assistance
- ☐ Serving as board director

Strive for world-class client service. We have never lost a client we didn't deserve to lose. We simply failed to deliver the service. We have been guilty of providing world-class service to our newest clients and taken-for-granted service to the older ones. Does this hit home?

In our accounting service practice, our policy is to complete the work within three business days of its arrival in our office. We think that's an example of world-class client service, and the clients agree.

We pet and pamper our clients—yes, we attempt to spoil them. We want them to become so dependent on us that they would never consider another firm.

Use the value-added billing system. We accountants are sticklers for determining fees by multiplying hours by rate. Certainly that's a standard, but our analysis of worth should go beyond that.

My belief in value billing came from an experience many years ago. A bill had been prepared using the multiplication method, but payment received was for a higher amount than I recalled the bill to be. We discovered that a typing error had been made on the bill amount—$600 instead of the intended $400. We received a $600 check. Something was happening here that I needed to understand. The client perceived value at $600.

We bill monthly and write detailed descriptions on our bills. It is not uncommon for a bill to be more than one page long. We have all our standard billing language stored in our computer, so billing is not a time-consuming task.

Create two tax seasons. We call the tax season from January 1 to April 15 the "compliance" tax season. The rest of the year we call the "planning" tax season. Our goal in the planning tax season is to create 100 percent of the fees generated during the compliance season, but to involve only one-third of the compliance clients. This is accomplished using tax-planning software from BNA Software, in Washington, D.C.

We also try to move as much work as possible out of the compliance season. We schedule client stock transactions during planning season. Clients arrange for us to receive duplicate copies of brokerage statements. We have converted personal financial statement year-ends from December 31 to months that fit our work load. Banks don't seem to care as long as they get an updated statement every year.

We prepare depreciation schedules during planning season using a computerized depreciation program. This provides accurate information for tax planning. In addition, the compliance preparation process is only slowed down for fixed asset additions/deletions. We do not use the depreciation calculations of our tax processor, Computax, because we do not want to learn two depreciation programs.

Present client seminars. We present an annual, year-end tax planning client seminar, complete with color slides, speaker script, planning assistance, and handouts. We purchase this material from Mayer, Hoffman, McCann, a CPA firm in Kansas City. There is no reason for us to reinvent the wheel.

We present seminars because they are an efficient means of communicating the same information to a lot of people. They also help in answering that typical question, "Why didn't you tell me about that?" Our reply: "We missed you at our seminar where that was discussed."

Send client newsletters. We send out a quarterly newsletter and other printed information from time to time. We produce none of it in-house. Most of it is purchased from Mayer, Hoffman, McCann, mentioned above. Incidentally, Judith R. Trepeck's presentation on producing an in-house newsletter at the 1988 AICPA Small Firm Conference is making us reconsider our method of production. (See "How to Produce an Effective Firm Newsletter" in the April 1989 issue, page 5.) The purpose of the written mail-outs is to provide information and to get our firm name in as many places as possible.

Overdo CPE and don't discriminate. All our associates attend CPE and at least one course annually is out of town. It's the best investment we make.

Provide tools for your associates. Our clients and associates make our firm. We have world-class associates. People are provided with a computer, dictaphone, private office, authority and responsibility, and enough rope to climb the tree or to hang themselves. The right people make the climb. If your associates want to show off their place of work, you must be doing something right.

Implement a team philosophy. In our firm, all seven associates make up our team. When any one is out or does not execute properly, the team does not function as efficiently. Three of our associates are CPAs, but all seven are gifted members of our team.

These thoughts are shared in the hope that other small practitioners will consider alternatives to the traditional CPA practice. Ours is but one of those alternatives. ☑

—by **Ron W. Stewart, CPA,** *Stewart & Company, CPAs, P.O. Drawer 7360, 1811 Tower Drive, Suite A, Monroe, Louisiana 71211-7360, tel: (318) 388-3108*

A PRACTICE SURVIVAL PRIMER

September 1990

Because of my extensive research, teaching, and writing on the subject of beginning practitioners, I am often asked about the essentials for a new practice's profitable survival. With the many changes taking place in the profession today, there are, obviously, a number of critical factors. I believe, though, that the following areas are probably the most pertinent for all firms.

Concentrate on what you do best, what you like most, and what generates a reasonable profit

That a CPA would do the opposite of the above might seem a little farfetched. In reality, it is not. Many practitioners allow their practices and clients to control them, rather than the reverse. Beginning practitioners are particularly susceptible to this, as they feel compelled to accept most client opportunities. There is always concern as to whether they will be able to obtain sufficient numbers of clients to succeed. Often, they accept work in an unfamiliar area, take extra time to complete the engagement, but don't charge for the "training time." The result is a write-off of hours and fees.

If you are working in an area you like and are good at, it seems reasonable that profit would follow. The same principle applies for larger firms.

Partners and staff normally work best in situations where they are most comfortable. This suggests areas in which they have knowledge, can reasonably accomplish every assigned task, yet still feel challenged. Taking people out of their "comfort zone" frequently results in attitude problems, errors, and write-offs.

Restrict areas of service to correlate with firm's size and availability of talent
Consolidation of talent has been suggested as one of the factors giving rise to mergers of national firms. If these firms, prior to the mergers, did not have all the skills needed to meet perceived and actual client demands, how could smaller firms? The answer is that small firms cannot. So don't even try.

For years, practitioners believed they had to be all things to all clients, and that they could adequately provide all of the services clients wanted or needed. This concept is particularly inappropriate today, for beginning practitioners and smaller firms, and might even be inappropriate for larger firms, too.

The decision on which services to offer starts with an analysis of how cost-effective you are in providing various types of services, the demand for these services, and the risk and exposure associated with providing them. Even though the end result of this constriction is to offer less varied services, significant client loss should not occur if the practitioner always tends to clients' needs and always provides timely, competent service.

Surround yourself with a professional environment
Large CPA firms have access to a multitude of talents and skills through their national and international organizations. Other sizable firms can share information and obtain assistance through membership in associations of accounting firms. Small firms are less likely to have such sources of professional help and tend to rely upon a small group of peers, their state societies, and the AICPA. Many, however, don't fully utilize even these resources.

Technical assistance is offered by the AICPA, for example, through its technical information and library services. Information on these member services is regularly published on page 4 of the February, May, August, and November issues of the *Practicing CPA*. In addition, the Institute has a software support service to assist practitioners in using AICPA software. Keep in mind, too, that there may be a specialist among your peers to whom you can refer, or someone at your state society who can provide professional assistance.

Market, market, and market some more
Because of the trend toward increased specialization, marketing efforts will probably become more targeted. If you have identified a niche or some type of concentration in your practice, you should take every opportunity to develop and market it.

Historically, clients leave CPA firms over service or fee disputes. Lack of timely service and lack of contact with the CPA are commonly cited as significant problems. Fee disputes can frequently be avoided, or at least minimized, through the use of engagement letters and proper communication at the onset of the engagement.

You should closely monitor the sources of new clients. Then, increase marketing efforts where results are evident and decrease the efforts where they are not. Most important, always acknowledge referrals in an appropriate manner.

You should market when clients are seeking the service—even during tax season. There should be a touch of marketing to all aspects of your practice's operation. This would include the finished products offered to clients, the professional image projected by the firm and its staff, personal appearance, and office facilities. While marketing is not necessarily a round-the-clock effort, you should always be alert to practice development opportunities.

Create a niche
I mentioned practice niches in the previous section. Rather than wait for a niche to become apparent, however, I suggest you take steps to create one. The approach should be marketing oriented.

You can start by considering the skills and characteristics of firm personnel and try to match these with service situations and activities. You can take into account personal and leisure-time pursuits, and professional and community involvements to see whether these offer insights or opportunities to differentiate yourself from other CPAs.

Acquire quality, not quantity
At this stage, I think a word of caution is due about engaging in cost-recovery or off-season work, and acquiring clients. Always be wary of becoming involved in client situations that might be more trouble than they are worth. Determine first whether the addition of any client will add to your overall practice profitability and enhance your image in the community. No client should be added who does not conform to your practice guidelines and overall plan.

A plan of action for profitable survival
The plan briefly outlined below is based on the Colorado Society of CPAs' CPE course, "Shaping Your Practice for Profitable Survival in the 1990s." The ideas can be helpful to long-established firms as well as the one-person, newly founded practice.

- ☐ First, study the ongoing changes in the profession so that you are aware of their impact on your firm and on the services you presently provide. Make a note of client requests for new services, new marketing techniques, developments in office automation, information processing, and communication equipment.
- ☐ Then, complete a detailed inventory of firm personnel and the services you are capable of offering. Consider technical knowledge such as computer skills, marketing capabilities, and

other areas of expertise. Also, determine whether you have sufficient resources to satisfy your needs, and can replenish these resources as demand requires. Determine a direction for the firm based on your analysis of the above.

- ☐ Develop an organizational structure to achieve your goals. The process should include a review of administrative procedures, such as report and return processing, filing and documentation, billing and collection, and personnel management. The structure should permit everyone in the organization to work to the utmost of his or her ability. There should be a system to monitor progress. Then, if someone is not going along with the program, you can make the necessary corrections.
- ☐ Develop a marketing plan with an emphasis on present clients and referral sources. Key the marketing plan to the strengths that you have identified in the firm, and make sure that adequate time and money is devoted to reaching your goals. Again, monitor performance and make adjustments where necessary.

You will have to be alert and responsive to change in order to survive and prosper in the 1990s. So stay current and develop an external support system of peers, specialists, and others who can help you in areas where you are not strong. It is perfectly all right to ask for assistance. It can make the difference that helps you survive. ☑

—by **Albert S. Williams, CPA,** *Williams, Betzer & Co., 950 South Cherry, Suite 118, Denver, Colorado 80222*

Section 3

ALL ABOUT OFFICES

CHOOSING A LOCATION

December 1985

In a study conducted for my Ph.D. dissertation, "Development of General Criteria Applicable for the Establishment of a New Accounting Practice," I first hypothesized that the amount of success a firm could expect would be dependent upon several factors, such as types of services provided, staff qualifications and training, methods of obtaining clients, office location, management systems and planning methods. Of the various factors, the questions I asked practitioners on selecting a location generated the most interesting responses.

The study was conducted in two ways. I mailed questionnaires to 350 practitioners located in cities, medium-size towns and small towns in seven Southeastern states in a 5:3:2 ratio, respectively. There were 165 responses in approximately the same ratio as the mailings. At the same time, I conducted 40 interviews in four Southeastern states in the same 5:3:2 location ratio of cities, medium-size towns and small towns.

The responses were analyzed in accordance with the study's objectives and categorized by states, by questionnaires versus interviews and by size of cities and towns. The results provide data on current practices and contemporary opinions and permit some basic conclusions to be drawn about where to establish a new accounting practice or where to locate a new office of an existing practice.

For example, responses to a request to describe exact locations indicate that, although accountants are opening offices in suburban areas, 63 percent of the respondents are still located in downtown areas and about 43 percent are situated in multi-firm office buildings. There were no substantial differences among states or among cities and towns of different sizes, and the responses also showed that a few firms with offices in large suburban shopping centers seemed to be doing well.

Fifty-eight percent of the respondents said they believe the location of a firm within a city or town does have an effect upon its success. Unexpectedly, the number of practitioners from small towns who agreed with that statement was almost double the number who did not. In the cities, there was barely a majority that agreed.

The most common reason given for having selected a particular location was its proximity to many businesses. Next came "near a bank" and "it was one of the most attractive offices available." Some other reasons included easy accessibility, good parking facilities, convenient location, being in a growth area, being in a professional building, a chance to purchase the building, being close to law firms and being close to an Internal Revenue Service office.

When asked for their opinions on what constitutes the best possible location for a new office, most practitioners were in agreement that being close to many businesses, having an attractive office and good parking facilities were all essential requirements. Ideally, the location would have all three of these assets.

(Like the questionnaire respondents, most of the accountants interviewed were in offices located in downtown areas among many businesses. Many had attractive offices, but some of the longer-established firms, located in older buildings, did not. A large majority had poor office parking facilities, and many stressed that such a situation creates difficulties for some clients. In some downtown areas it is, of course, hard to find an office that has good parking facilities and yet is still close to other businesses.)

The remainder of the questions were designed to elicit information as to why the accountants chose their particular locations, the amount of business they currently have and whether there is a demand for accounting firms in their practice areas.

About 39 percent of the respondents chose a particular city or town because it was the place in which they had been brought up. Only 26 percent selected a location because they had determined that there was a demand for accounting firms in that area—an indication that personal factors may sometimes play more important roles than economic ones. On the other hand, some practitioners may think it better to locate where they know many people because this may make it easier to obtain clients. Twenty-six percent of the respondents purchased existing firms already established in a particular area, and 15 percent stated that they just liked the locale.

Some interesting differences were found relative to the size of the city or town. Almost one half of the practitioners located in cities chose the area because this was where they had roots. The need for accounting firms in these cities did not seem to be the overriding issue. This was not the case in medium-size and small towns, however, where the need for accounting firms was just as influential as the desire to locate in the area.

Over 50 percent of the practitioners believed that they had enough work to keep them busy, whereas 5 percent thought they had too much and 5 percent not enough work. About 20 percent said that business could be greater, but several said they would give this reply no matter how busy they were. Responses to this question were similar in every state, city and town.

Most practitioners (83 percent) believed that there were approximately the right number of firms to meet the service demands in their areas, 8 percent said there were too many firms and 9 percent not enough.

Other studies suggest that additional considerations in the choice of a location might include whether the area is dynamic and growing and will support the desired practice and living standards. Office layout and facilities might also be considered as well as the advantages of establishing a practice in a suburban area if businesses are moving there. Whether urban or suburban, the chosen locality should, in any case, be consistent with the dignity of the profession, in reasonable proximity to present clients and in an area most likely to furnish new ones.

In conclusion, it appears that the selection of a city or town in which to locate an accounting firm is often influenced by personal considerations, but it might be wise for potential practitioners to determine first the need for those services they can provide. In addition, it would be prudent to locate the firm in an attractive office with good parking facilities, close to businesses, banks and law firms. ☑

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A CPA'S GUIDE TO INFORMED OFFICE SPACE DECISIONS

September 1987

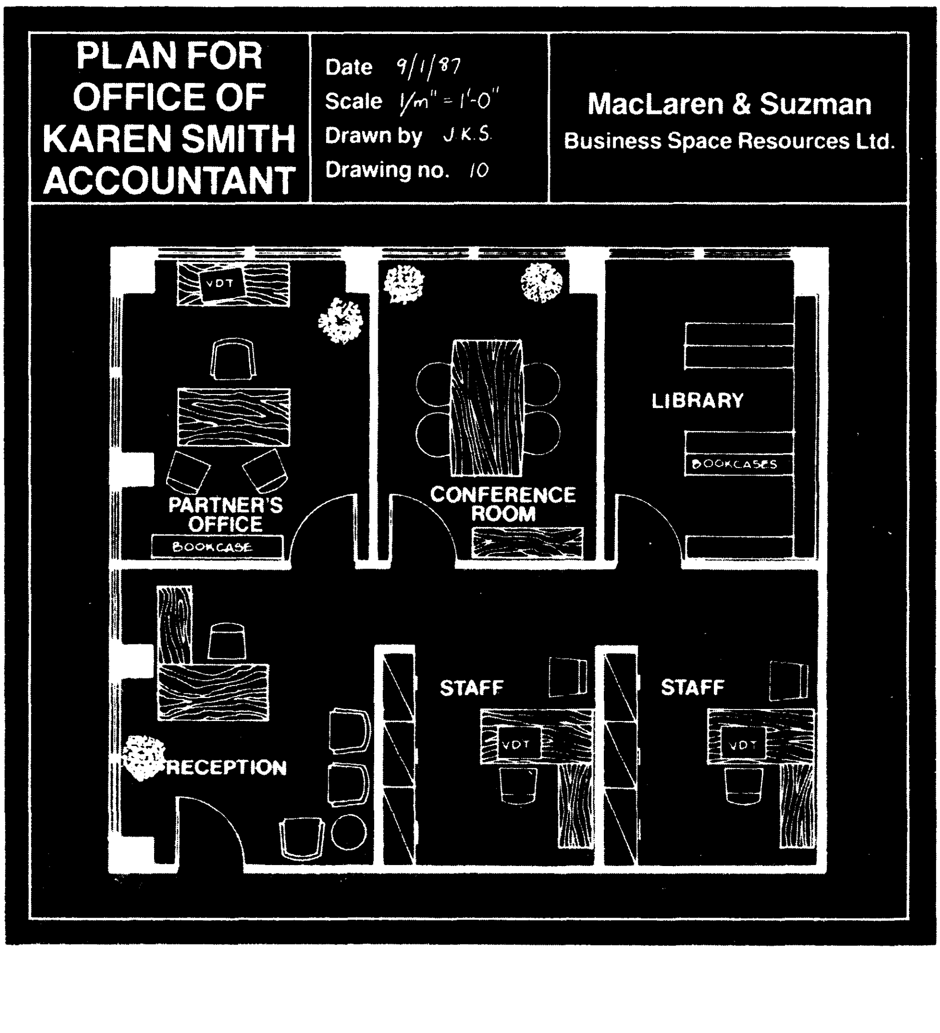
Office occupancy costs are typically an accounting firm's second or third largest partnership expense. The fact that office space decisions are normally made only once every three to ten years, when the lease expires, increases the difficulty of making really knowledgeable choices. The problem is further compounded by the need for the partners to reach consensus on a topic that can often be as emotional as buying one's house.

Many firms *do* approach their office space decisions as if they were buying a house. They guess how much space they want, how much they can afford to spend in monthly rent, and generally where they would like to be located. They then engage a real estate broker, frequently not realizing that he or she usually represents the landlord, to show them what's available. Finally, they find themselves negotiating with a landlord who bargains with prospective tenants every day.

There is a better way. Truly informed real estate decisions require a systems approach—one that comprises a sequence of distinct steps. While the steps are always the same, the amount that needs to be done in each step depends on how much business space is involved. The larger the space, the more money that can be saved and the greater the effort that can be justified to achieve minimum rental costs.

Business Space Resources Ltd. (BSR), a Seattle, Washington, firm which specializes in representing and negotiating for tenants, has researched how various-size Seattle accounting firms make their office space decisions. The firms are categorized as national, with more than ten local partners, or local, ranging from small (two to four partners), to medium (six to eight partners), to large (more than ten partners). The results are summarized in the accompanying table.

As you might expect, the larger the firm, the more formalized and detailed each step becomes. This



reflects the amount of partner time that can be justified, relative to what can be achieved in terms of occupancy savings. For example, the equivalent of a \$1/sq.ft./year reduction in rent over a three-year lease on the 2,500 square feet that a small local firm might occupy is worth \$7,500, while for a 25,000-square-foot ten-year lease that a national firm might be negotiating, it is \$250,000.

Let's look at each step of the process and consider the amount of detail involved to reach an informed real estate decision as a function of firm size. Common to all situations, however, is the need for the partners to build consensus and clearly establish the responsibility for each step at the outset, whether they chose to handle the entire process themselves or to hire a consultant as a facilitator.

We should mention that in choosing such a facilitator, the steps are the same as when a client engages an accounting firm: asking for qualifications; interviewing those who would actually be involved and clarifying their experience; checking references; and understanding the fee structure. We might also suggest that, before signing a contract, you work initially on an ad hoc hourly basis until you feel comfortable with the consultant.

Make space needs part of business planning

The larger the firm, the greater the need for a long-range business plan that includes a forecast of office space needs to show when and how they will be met. Small firms seem to feel their way along, perhaps providing room to add an extra person over the lease term which tends to be shorter to allow for uncertainties. The largest firms have formalized business plans which include space projections reviewed by head office space planners and approved by the regional partner.

Understand and quantify space requirements

For the smaller firms, this can frequently be done by extrapolating from the present space. However, for larger firms, the partners should consider hiring an architectural space planner to quantify and schedule future space needs based on the firm's business plan. Medium-size partnerships should at least rough out the type and size of the space they think they will need and let the space planner in the building of choice fine tune it.

Establish priorities and criteria

Here again, the larger the firm, the more time taken to build consensus among the partners as to where their firm should be located. There needs to be agreement on such things as: building location (central business district or suburbs), building style (new or rehabilitated), building type (low or high-rise), building image, building layout (single or multiple floors), local amenities, and building services. The smallest firms agree only on the general area in which they'd like to be and then rely on a "we'll know it when we see it" approach. At the opposite extreme, the national firms may assess their priorities and criteria against what is available in the marketplace with the help of a consultant or tenant's representative. They are also concerned about their major clients' opinions of the neighborhoods that they are considering.

Consider alternative approaches

Alternative approaches include staying in one's present building, moving to a new location with the same or different landlord, and having a building built or rehabilitated. Leasing was the alternative chosen by all of the Seattle firms that were interviewed. Some national organizations do own their buildings in other major cities. The local firms briefly considered ownership but were either too small to make it worthwhile or didn't want to be a landlord for other tenants.

Thoroughly survey the market

The extent to which the partners were involved in searching the market again reflected their numbers. For the smallest firms, the search is often done by the office manager with all of the partners visiting several buildings to narrow the choice. As the size of the firm increases, one or more partners work with real estate brokers or a tenant's representative to identify and narrow the possibilities. (The largest firms liked the idea of an independent representative to act as a buffer between them and any landlords or developers who were a client.) The resulting names are then sent requests for proposals (RFPs) to serve as the basis for analysis and negotiation.

Analyze the RFPs objectively

The evaluation of the alternatives should be on an apples-to-apples basis, the rental rate being only one of a number of factors such as: build-out allowance (tenant improvements), stepwise rental increases (periodic scheduled increases), rent abatement, drawdown of pocket space (space not yet occupied), limits on operating cost pass-throughs in future years (annual increases), moving costs, and parking. Studies by BSR Ltd., indicate that all of these factors can have an impact and that no one of them accounts for more than 25 percent of the total savings. Equally important is that each situation is different, requiring comprehensive economic evaluation. As would be expected, all of the firms, regardless of their size, did economic evaluations of the various proposals to narrow the choice to a couple of finalists for the actual negotiations. Again, the national firms, who could justify the time, used the most sophisticated approach with a matrix of present worth and qualitative factors.

Plan for negotiations

The most effective negotiations depend on: a concensus among and clear direction from the partners, understanding the alternatives and trade-offs,

	Local firms	
Basic tasks	**Small (two to four partners)**	**Medium (six to eight partners)**
Make space needs part of business planning	No formal plan except to allow adding one CPA over lease term	Conceptual plan to continue historic growth
Understand and quantify requirements	Simple extrapolation from existing space	Simple extrapolation from existing space
Establish priorities and criteria	Partners only agreed on general location; then "I'll know it, when I see it"	All partners reached consensus after several meetings on general location, building image and accessibility, proximity to amenities
Consider alternative approaches	Only considered equity participation which they couldn't afford	Only considered their own building which was either too small or required becoming a landlord
Thoroughly survey the market	Done by office manager; all partners visited several locations to choose finalists	Done by one partner with some help from real estate brokers
Analyze objectively	Did orientation economics	Played "what if" on alternatives
Plan for negotiation	Done by managing partner with no preparation beyond orientation economics	Done by managing partner with no preparation beyond "what if" economics
Tailor the lease	Regular attorney reviewed landlord's lease	Regular attorney reviewed landlord's lease
Monitor build-out	Relied on landlord to provide turnkey	Used own interior designer to work with landlord's contractor on turnkey basis
Plan move-in and follow-up	Relied on moving company and landlord's contractor to correct problems	Office manager coordinated a weekend move with moving company and prepared list of problems

a real fall-back position, knowing the situation of the landlords with whom you are negotiating, and leaving plenty of time. In this step, with the exception of the national firms, the managing partner did the negotiating with continuing input from the other partners. Interestingly, those firms used a two-partner team with continuing input from a tenant's representative.

Tailor the lease

Once agreement has been reached, it must be translated into a lease, fair to both tenant and landlord. Since the lease is a contract, it should be reviewed by an attorney who, preferably, frequently deals with leases. The local firms, however, all used their corporate attorneys to adopt the landlord's lease to their own situations. Only the national firms used their own standard leases as the starting point, with input from their tenant's representatives and local counsels who had real estate departments; approval was ultimately from head office.

Monitor space build-out

Again, the level of involvement increases with the size of the firm, ranging from simply leaving it up to the landlord to do a turnkey build-out, to having a team (a partner, the office manager, and an administrator) highly involved with an interior designer and the landlord's forces. Regardless of the level of involvement, however, it is important to establish who is responsible for making decisions at the various stages, be they architect (space planner/interior designer), the landlord, his contractor, the tenant, or the installer of office systems. This team should

Large (more than 10 partners)	**National firms** **More than ten local partners**
Conceptual plan to continue historic growth	Formal five-year plan with space projections approved by headquarters space planner
Simple extrapolation from existing space with flexibility provided by second local office	Apply national space and occupancy cost standards to local business plan projections
All partners reached consensus after several meetings on general location, building image and accessibility, proximity to clients and amenities	All partners weighed priorities and criteria against space availability using a real estate consultant/tenant representative
Leasing considered only real alternative	National organization established leasing as best local alternative
All partners commissioned two or more partners as alternative premises committee (APC) to work through real estate brokers	All partners selected a tenant's representative to survey market and act as a buffer with landlords who were clients
Iterative trade-off analysis to narrow choices	Tenant's representative worked with all partners to prepare present worth/qualitative factor matrix
Done by managing partner with no preparation beyond iterative trade-off analysis	Two knowledgeable partners negotiated based on trade-off analysis and continuing input from all partners
Regular attorney reviewed landlord's lease	Used own lease for negotiations with landlord together with input from tenant's representative/local counsel final lease approved in headquarters
APC hired own interior designer and agreed on items above building standards to be built by landlord's contractor	APC handled all details with continuing input from all partners. Office manager monitored build-out and ordered furniture/telephones
One partner managed entire process using a moving checklist	Office manager selected moving company and coordinated move and follow-up

establish the scope of work and jointly set procedures and a critical path schedule to complete the build-out in a timely fashion. For major jobs, there should be an overall project coordinator to keep the entire process on schedule.

Plan move-in and follow up

In this step, each firm singled out an individual, usually but not always the office manager, to oversee the process. This activity should ideally begin with the interior design work to allow adequate time to procure long lead-time items like new furniture and telephone/computer equipment. As the moving date approaches, this individual must also hire a reputable mover, brief the employees on what has to be done, coordinate installation of all equipment, be sure that the space is actually ready before starting the move, and finally be available during the move to answer questions and solve problems. After the move-in, this person should also follow up on any problems.

The next time your lease comes up for renewal, don't make the mistake of assuming that only partner hours will be needed. The process can take months and be very divisive unless planned. A systematic approach, with clearly defined responsibilities, can minimize not only the partners' valuable time, but also the ultimate occupancy costs. ☑

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MOVING TO A NEW OFFICE

November 1978

If carefully planned, moving into a new office can be accomplished with little disruption of the normal operations of a firm. Section 210.11 of the *MAP Handbook* contains a number of helpful ideas in this regard. Here are some of them:

- ☐ Have one office representative to coordinate and be in charge of all aspects of the move. Assistants may be necessary if the logistics are complicated.
- ☐ Set the moving date well in advance to allow time to coordinate activities of all concerned.
- ☐ The mover should make a survey of furnishings and other items to determine the proper amount and type of moving equipment and manpower needed.
- ☐ Prepare a layout of the new space with certain areas color coded and offices numbered. Furniture and other items should have labels attached indicating the new location.
- ☐ Take an inventory of all items to be moved. This is a good time to dispose of unneeded furniture and equipment.
- ☐ Boxes should be distributed to each department so that the staff may pack personal and assigned items.
- ☐ The moving of rented or leased equipment should be arranged with the owner so that damage is minimized. Responsibility for possible damage should be established.
- ☐ Instructions and plans for the move should be communicated to all personnel.
- ☐ Firm personnel who are familiar with the items to be moved should be chosen to represent each department and only they and the coordinating individual should be present at the new quarters when the moving trucks arrive.
- ☐ The coordinators should be alert to and note any damage committed by the mover. (Instances can be noted on the mover's invoice before signing it.) Damages discovered later should be reported promptly to the moving company.
- ☐ Unpacking (except for personal items) should begin as soon as the mover leaves and, if possible, accomplished over a weekend so that the firm's regular operations may begin on the following Monday morning.
- ☐ At the time the staff is unpacking personal items and settling into the new offices, a janitor or handyman should be present to hang pictures or make adjustments to complete the move and make the new quarters pleasant and efficient as soon as possible.

Sec. 210.11 of the *MAP Handbook* is one of 10 sections that were added to this reference work in October 1977. Two other sections were completely rewritten to provide expanded discussion, current material and related illustrative forms, and the supplement also included updated materials for several other chapters.

Currently, the MAP committee has several task forces at work on material for a supplement to be ready about next May. New topics will include suggested assignments for an office manager, advice concerning government engagements and ways to manage time more efficiently.

In addition, the section on partnership agreements will be expanded and the coverage of topics such as the use of computers, college recruiting, long-range planning, in-house training and growth through specialization will be updated or increased.

ESTABLISHING AND RUNNING BRANCH OFFICES

September 1978

There are several factors to consider before opening a branch office, and it is also important to examine the concept of branch offices and its relationship to the firm's long-range plans. Carefully developed plans and ideas should not be abandoned merely to permit operating within a multi-office framework.

Here are a number of reasons for opening a branch office:

- ☐ If the firm has several clients concentrated in a relatively small area some distance from the existing office.
- ☐ If travel time and expense become major factors in servicing a number of clients.
- ☐ If important clients establish operations in a particular area.
- ☐ If the accessability of the CPA firm to the client is materially improved.
- ☐ In order to penetrate a potential market for new clients.

It can be advantageous for the firm to be represented in a prosperous business community. Evidence of such an environment includes

- ☐ Established population growth trends.
- ☐ Low unemployment.
- ☐ A significant number of new business starts.
- ☐ The relocation of established businesses into the area.

- ☐ Strong banking and lending institutions.
- ☐ Progressive civic leadership.

The establishment of a branch office can open up opportunities for advancement if the firm has a number of highly qualified people at the manager level, and there may be advantages to relocating someone with a particular technical expertise near clients in that industry.

But there are some negatives to consider as well. Not all members of the staff may wish to sever business and family relationships to start anew in another location. However, these problems can be overcome with careful planning.

When opening a branch office, the decision must be made whether to start from scratch, or acquire or merge with an existing practice.

In starting from scratch, the firm has more flexibility in choosing a location, more opportunities to place its personnel and fewer problems in indoctrinating the staff in its technical and administrative procedures.

Nevertheless, the financial risk can be substantial, particularly if there are no existing clients in the desired location. The presence of some clients will lessen the financial commitment by the reduction in travel and other expenses incurred in servicing them from the present home office.

The financial risk can be reduced through acquiring an existing practice if it is of the desired quality and can be retained afterwards.

Before acquiring practice, a CPA firm should

- ☐ Make sure that the agreement
  - (1) Provides for the continuance of desired personnel of the acquired firm.
  - (2) Contains provisions for the retention of existing clients.
- ☐ Conduct a thorough review of the practice, areas of importance being
  - (1) Size of the practice in chargeable hours and revenues.
  - (2) Technical competence and number of personnel.
  - (3) Types of engagements performed.
  - (4) Administrative and technical procedures employed.
  - (5) Relations with existing clients.
  - (6) Potential of existing clients.
  - (7) Collection records.
  - (8) Levels of pay and fringe benefits.

It is a good idea to make a list of factors to be considered during the review of a possible acquisition candidate.

Some firms have found that the best solution to the problems that arise in opening a branch office is to acquire an existing practice and supplement it with clients and personnel from the parent firm. This way they can obtain some of the advantages of both methods.

Guidelines must be established to ensure that the technical and administrative procedures followed by the new office are the same as those used by all other offices of the firm.

Technical quality can be obtained by having all reports centrally reviewed or by utilizing interoffice quality reviews.

Over time, the firm must establish recruiting, training and supervisory procedures and monitor them to promote consistency in all offices.

If the firm has several branch offices, a committee can be established with representatives from different locations to provide input for new firm procedures, prepare position papers and monitor the technical quality of the practice.

Goals should be established for the office, taking into consideration the longer-term viewpoint of the office becoming a viable, profitable and self-sustaining division of the firm.

Sufficient resources of manpower and capital must be committed to the development of the new office even if this means setting the budget at levels that would be unacceptable for established offices. As the new office progresses, the budgeting for it will gradually conform to that for other offices.

In the beginning, many hours of nonchargeable time may be necessary for client relations and practice development and, during peak periods of personnel needs, it may be necessary to assign additional staff from other offices. Scheduling needs must be communicated promptly if staff are to be available when needed.

Start-up costs for a new office can be high. Expenses include those for furniture, equipment and supplies, various deposits for utilities and leases, and association dues and fees for civic and social clubs. There will also be moving expenses for staff assigned to the new office and costs associated with entertainment and promotion.

Most of these expenses are unusually high for a short period although those for client relations and promotion may continue that way for several years if the practice is to be properly developed.

Procedures must be set to monitor the branch office with minimum effort and paperwork. The major areas to be monitored are:

- ☐ *Personnel utilization.* Proper scheduling, budgeting and coordination with other offices should be established. The branch office should report any staff shortages as soon as possible for budgeting purposes.
- ☐ *Technical quality control.* Absolute compliance is a must because when a firm operates with more than one set of technical standards it results in confusion, lower work quality and, ultimately, loss of clients.
- ☐ *Financial operations.* No matter what the level of involvement by the branch office, all

financial activity should be reported to the home office periodically. The branch office should prepare a monthly financial statement for the home office that permits comparison of actual performance with pre-determined budgets.

The evaluation of the branch office must give recognition to the fact that although goals were realistic at the time they were established, they may now be unacceptable, and alternative courses of action may have to be considered.

In any event, the firm must be prepared to take quick, responsive action to cure any unsatisfactory performance by a branch office and not delay decisions until the firm's welfare is harmed.

To keep the operations of branches running smoothly, meetings between home and branch office personnel should be held frequently. The participation of junior staff people in the deliberations will give them recognition and boost morale.

MANAGING A MULTIOFFICE FIRM

November 1982

Running a one-office firm can be difficult enough, so why would anyone risk making the operation even more complicated by opening other offices? The following answers to this question and some suggestions for managing a multioffice firm are based on presentations at AICPA MAP conferences by Edmond L. Smith, CPA, Marshfield, Wisconsin; David A. Tonneson, CPA, Wakefield, Massachusetts; and Robert F. Warwick, CPA, Wilmington, North Carolina.

Sometimes, two or more offices will provide additional growth opportunities for the firm or permit it to offer better services or quicker response to clients. Also, if the nature of the practice necessitates considerable staff travel, opening other offices can reduce this and perhaps even result in lower staff turnover if time away from home is a problem. Another valid reason for having more than one office might be that a firm has a number of outstanding people it wants to keep and believes that a multioffice operation will provide advancement opportunities for them.

Opening another office should be a carefully planned operation and must be in keeping with your overall growth plan. There are a number of approaches you can take. You might find, for example, that a merger with another operating practice can be beneficial to all concerned. Or perhaps you would prefer to buy out another practice. Also, if you have a few clients in another location to reduce the level of financial risk to the firm, starting a new office from scratch might be the more advantageous route.

If you are opening a new office, there are a number of considerations to bear in mind in selecting the site. The more obvious ones include accessibility to clients and an economically viable area that provides both growth potential and an attractive environment for staff.

Staffing needs will be different with each situation—the nature of the work governing the mix of professionals and paraprofessionals, etc. If you can, it is better to promote from your present staff to fill positions than to hire from outside the firm. Someone must be in charge of the office—someone who is good at client relations—and while this person need

Problems of operating multistate offices

Licensing problems

- ☐ Reciprocal certificates
- ☐ All partners licensed in the state
- ☐ Time delays
- ☐ Transferring people across state lines (CPAs)—residence requirements

Tax problems

- ☐ Partnership—allocation of income
- ☐ Partners—filing multistate returns
- ☐ Multiple state payroll tax reports
- ☐ Corporation—allocation of income

Legal problems

- ☐ Laws governing CPA practice
- ☐ Different code of ethics (state boards)
- ☐ Need for attorney familiar with state law
- ☐ State laws to be familiar with
  1) Leases
  2) State minimum wage
  3) Employment agreements—noncompetes
  4) Laws governing credit and collections

Professional corporations

- ☐ Separate professional corporation for each state
- ☐ Some states require all stockholders to be licensed CPAs in that state
- ☐ Laws different for each state

Other potential problems

- ☐ Does the state license public accountants—professional image
- ☐ Do you have adequate contacts with
  1) Bankers
  2) Attorneys
  3) State CPA association
  4) Colleges and universities (recruiting)

Quality control problems

- ☐ Auditing and accounting
  1) Familiarity with multiple state laws for reporting purposes
- ☐ Tax department
  1) Partner familiarity with multiple state laws for income tax, payroll tax and property tax filing
  2) Training staff—separate state tax courses
  3) Processing returns on computer—multiple state programs

not necessarily be a partner, partner responsibility for the office is a must.

Good communication between offices is essential, too, if the new office is to be viable. Procedures and routines for billing, time and expense reporting must be established, put in writing and communicated to staff. Forms must be standardized between offices if there has been a merger or buyout to avoid confusion.

Distance between offices can make the processing of work difficult and you may have to rely quite heavily on telephone calls and memorandums to staff. If you are to keep on top of such decentralized operations, you must have regular partner and staff meetings at which each office is represented.

One firm decided to open an office in another location because many high-technology companies—a field in which its staff had developed considerable expertise—had moved there. Growth is an integral part of this firm's philosophy and opening another office was viewed as an opportunity to give the firm a good image with the total regional business community. Since they weren't known in the new location, the partners decided that the office needed the status of the in-charge accountant being a partner. After considerable deliberation as to who would be the right person for the job, they selected someone who only recently had been made a partner.

The firm provides strong home-office support for the branch office. They have two partners present at the first meeting with new clients and the managing partner visits twice a month. The home office handles all billing and collections, staff training and quality control reviews.

The city, type and actual location of the new premises were dictated by the need to be both attractive and accessible to the high-technology companies in the area and to the bankers and attorneys, its main source of referrals.

Once settled in a new office, how can a firm quickly establish its identity? This particular CPA firm decided to budget a realistic promotional program. They determined that the best type of activity would be for the new partner to join trade and civic organizations and to engage in speaking and writing assignments so that he would become known. Although the concept of the firm as a single entity was strained a little at first, mainly due to lack of time to work with the new partner, the firm considers the new office very successful in terms of growth and profits.

Section 4

PLANNING

THE ANNUAL PLANNING CYCLE

January 1978

Much has been said and written about the separate subjects of long-range planning, short-range planning, budgeting, forecasting, partners' retreats, practice management systems, reporting, etc. There is an interrelationship among all of these things—they are more than just a plan, a piece of paper, numbers, meetings and reports. When brought together, as they must be once each year, they cause things to happen and produce results for the firm.

The opportunities for local firms have never been better than they are right now, and chances are good that they will continue to improve. But, while the opportunities are there, specialization and organization are required to be able to respond to them. Service requirements are now so broad that in order to meet them, larger practice units are being created and firms are joining associations.

Growth is inevitable unless prevented, but growth alone is not the key. To be able to respond to these tremendous opportunities, you must have an organization with the capability to perform and effectively use its resources. This will be impossible without a strong workable partnership agreement and an effective organizational structure. It will require all of the aforementioned subjects, plus action, supervision and rewards. A long-range plan is the link that brings these elements together, makes things happen and produces results.

However, you must realize from the beginning that the growth and development of a firm must be built on quality service timely rendered, integrity, balance and control, and a strong desire to meet the needs of your clients. Any lesser efforts are doomed to failure.

There are certain essential policies and procedures that must be present for success. These are

- ☐ *Commitment.* You must convince yourself of the opportunities and of the need for planning and development of your firm. Organization must start at the top.
- ☐ *Planning—long and short-range.* The plan must be in writing, must be updated annually and must be communicated. (See the *MAP Handbook*, chapter 104.)
- ☐ *Organization.* You should have a strong partnership agreement. This is the basis of authority for the decisions that must be made. You will need an organization chart defining duties and responsibilities and will be forced to departmentalize and specialize to deal with the natural growth of the firm.
- ☐ *Personnel.* People are the most important ingredient, and it is essential to have the best and to believe in them.
- ☐ *Formal policies and procedures.* Producing formal policy and procedural manuals can be difficult for the individual firm. We find that being a member of an association is a great help in this regard.
- ☐ *Quality control—review procedures.* These determine the level of technical competence within the firm and are essential if you are to provide quality and timely services. These procedures become more complicated as the firm grows larger.
- ☐ *Management and leadership.* These are two different things. The managing partner is responsible for controls and reports (peer pressure is an effective control). A leader gives examples and creates opportunities and can be found at several levels within the firm.
- ☐ *One-firm concept.* You have the right to expect and demand the support of all partners and employees. Methods of settling differences should be predetermined. It is essential that the firm present one face to the world if it is to build a superior reputation, image and identity.

It is important that the partners of the firm be able to meet annually in an atmosphere conducive to the discussion of various aspects of the planning cycle. For the annual partners' retreat (advance), the right environment is most often at a site away from the office. Some planning is essential, however, if the partners' retreat is to be a success. So, about two months before the retreat is held, thought must be given to the areas to be discussed. Based on our experiences, the following topics should be considered.

- ☐ *Staff reviews.* You should request from staff members suggested time budgets with details on time other than chargeable time. This lets staff people have input to the budgets and gives them the feeling that their views are being considered.
- ☐ *Partners' reviews.* Cover partners' evaluation of themselves and other partners. Each partner should be given the chance to put his best foot forward. The reviews should be conducted far enough in advance of the partners' retreat that the managing partner has sufficient time in which to assimilate and evaluate the material.
- ☐ *Data and statistics.* Include the long-range plan and the annual, monthly and management reports. You must have these items before going to the retreat.

- ☐ *Agenda in advance.* Should cover the subjects and projects to be discussed and name the people responsible for leading the discussions to allow them time to prepare. Socializing is one of the most important parts of the retreat and the agenda should be set so as not to infringe on this time.
- ☐ *Departmental and functional objectives for the coming year.* No decisions are made at this point, but the process prepares department heads for what is expected of them at the retreat. It also allows problems to be aired and long-range plans to be updated.
- ☐ *State of the firm message.* Normally given by the managing partner who should make sure that the message is meaningful. Topics should include the accomplishments of the firm, matters of concern and the opportunities that exist. This builds up enthusiasm and anticipation. The major emphasis for the coming year must also be established.

The partners' retreat should follow the sequence of the prepared agenda, however, allocation of time to any specific subject should allow for a great deal of variance. The atmosphere at the retreat should be relaxed, informal and friendly to encourage a free flow of thoughts and ideas. The meeting rooms should not be the conference or classroom type, and the location should have adequate recreational facilities. Plenty of time should be allowed for the partners to get to know each other.

The long-range plan should be discussed and updated if necessary, as should significant projects and plans for the coming year. At this stage, there is still time to make further changes in responsibilities and in the organizational structure. Usually, no decisions are reached, but the consensus is summarized and the retreat is evaluated.

Obviously, the whole exercise is a waste of time unless decisions are forthcoming and action taken. In our firm, this occurs about one month after the partners' retreat. Again, it is essential that people know what their duties and responsibilities are and what is expected of them. The authority for making decisions must be clearly spelled out in the partnership agreement.

At this point, the long-range plan should be adopted, objectives determined and organizational structure finalized. Plans should be put into motion and communicated to the staff.

The annual budget should be completed and distributed. The budget details should include

- ☐ The expected growth rate, the firm's attitude toward acquisitions, mergers and expanding services. (These will allow you to determine your opportunities.)
- ☐ Time budgets, rate structure and gross revenue. (These will allow you to determine your capabilities.)
- ☐ An estimation of annual costs and expenses.
- ☐ Operating budget (annual).

After all plans have been put into effect, they must be supervised and controlled continuously to ensure that your goals will be achieved. You must know how you are progressing before it is too late to make necessary corrections. High standards of work and integrity can be maintained through an effective review system.

However, the bottom line will tell the story. As long as this is good, it is obvious that problems are being minimized. The following are three critical areas that if properly controlled will ensure success:

- ☐ *Productivity.* You will need input from partners and staff who have a joint responsibility to achieve the productivity rate (chargeable hours divided by total available hours) set by the firm. Productivity can be controlled through frequent time reports and summaries. Controls should be established by personnel classifications because of the different productivity standards. Our classifications and standards are: partners 50%, staff 80%, administrative staff 18% and overall 62%.
- ☐ *Realization.* Rates should be established for each individual, set at the upper limits and written down where necessary. (Use one of the methods described in the *MAP Handbook,* section 202.02, which are based on multiples.) Any variance in realizing the standard billing rate should be the subject matter of a monthly report to the managing partner, and variances in excess of a minimum amount should be stated in the annual financial report.
- ☐ *Collectibility.* Is the responsibility of the partner or client executive in charge of work and billings. The best way to go about this is through a front-end fee arrangement and prompt, adequate billing. There should be a review by a second partner and approval by the managing partner for any charge-offs. Control can be kept through a monthly, aged trial balance.

You must set up an adequate reporting system and provide everyone with what they need to know—no more. The use of the chart of accounts presented in section 201.02 of the *MAP Handbook* is recommended.

Another suggestion is to prepare an annual financial report and get it to the partners before the annual partners' meeting. (We have been doing this for 12 years.) The contents should comply with the firm's reporting policies to clients and contain an independence qualification, various financial statements and supplemental data. (See chapter 501 of the *MAP Handbook.*)

An annual report has much value and utility. It provides the partners with information they need, data for preparing proposals, statements for the AICPA division for firms and an annual comparison with other firms. Remember, your own firm is your best client.

Planning is an endless cycle. You finish one year, only to begin the next. This can be as discouraging to staff and partners as can be failure to take advantage of opportunities. It is up to the leader to maintain interest, enthusiasm and challenge. However, care should be taken that you don't grow too fast or push too hard since this can result in more serious problems.

Don't carry out a plan when you know it to be wrong. Adjust to the situation and be careful not to rationalize. But, you must be prepared for unexpected changes or opportunities that are not in the plan. Opportunities are created by a firm's track record and reputation, although mergers or acquisitions may be needed to take advantage of them.

There can be setbacks too. The loss of a senior partner or failure to develop new partners may force a downward revision in the long-range plan. Still, planning helps you recognize and identify problems that arise.

Continuous planning can offer rewards far beyond mere numbers. Ours is a working profession that will consume us unless we prevent it. If you wish to be master of your fate, you must make a definite commitment to planning and control. You have to decide where you want to be five to six years from now and the type of life you wish to lead.

But you must act now. If you wait for everything to be perfect, you will never get started.

– by Charles W. Jenkins, CPA
Albany, Georgia

DEVELOPING AND IMPLEMENTING A LONG-RANGE PLAN

September 1985

Mauldin & Jenkins is a local firm in a rural area. Albany, Georgia, is an agricultural crossroad, and ours is a general practice. That is what is needed there and at our three other locations in the state. We believe in offering our clients quality services and believe, also, that the outlook for local firms, such as ours, is good if we plan for the future. The need to plan is obvious.

Client and staff development are long-range propositions. So is developing the firm's capabilities. These undertakings must reflect the changing environment of public accounting so that the firm is able to take advantage of opportunities. The secret to success is not firm size, it is creating the capability to perform.

Performance means producing high-quality work, and this, in turn, necessitates maintaining the correct balance between staff and workload. The firm should also have other priorities.These are its bottom line, its practice development activities and the quality of life of its partners and staff. One is as important as the others.

Expectations—clients', staff's and your own—must be met or the firm won't be successful. All must be involved, be part of a team, if they are to perform at higher levels. It is a matter of setting challenging goals and of being able to adjust to opportunities. You must have the goods on the shelf (be they products or people) if you are to respond to opportunities.

The planning cycle

In our firm, we have a series of partner and staff reviews so that we can find out what their expectations are. This is followed by a planning retreat at which the intention is not to reach conclusions or make decisions but to create an environment in which people are free to come up with ideas. We find this type of partners' retreat beneficial because we leave it with the right attitudes for updating our firm's long-range plan.

We believe staff members should have input on budgeting, so we obtain their suggestions on time allocation and let them know their views are being considered. The budget details include

- ☐ The expected growth rate and the firm's attitude toward acquisitions, mergers and expanding services. (These allow us to determine opportunities.)
- ☐ Time budgets (established after discussion), rate structure and gross revenue. (These allow us to determine our capabilities.)
- ☐ An estimation of annual costs and expenses.
- ☐ The annual operating budget.

Supervision and control are essential to maintain high work standards and achieve goals. Timely corrections must be made where necessary, and proper control of the following areas is critical for success:

- ☐ *Productivity.* We get input from partners and staff who have a joint responsibility to achieve the productivity rate (chargeable hours divided by total available hours) set by the firm. Productivity can be controlled through frequent time reports and summaries. Controls should be established by personnel classifications because of the different productivity standards.

- ☐ *Realization.* Rates are established for each individual, set at the upper limits and written down where necessary. Any variance in realizing the standard billing rate is the subject of a monthly report to the managing partner, and variances in excess of a certain amount are stated in the annual financial report.
- ☐ *Collectibility.* A front-end fee arrangement and prompt, adequate billing solve some of these problems. At our firm, collections are the responsibility of the partner in charge of work and billings. There is also a review by a second partner, and approval of the managing partner is needed for any charge-offs.

In regard to the collection of fees from our clients, we use a 75-day report, which relates 75 days of production to the total fees, work in process and accounts receivable. The reports of partners whose work in process and accounts receivable exceed the total of the 75 days of production on their clients are marked in red. Those showing work in process and accounts receivable to be less than the total of the 75 days of production are marked in black. The reports are issued monthly, by partner, and state the amount by which each exceeds or is short of 75 days' production.

An adequate reporting system is essential. Everyone should be provided with what he or she needs to know—no more. One suggestion is to use the chart of accounts that is presented in section 201.02 of the AICPA *Management of an Accounting Practice Handbook.* We also prepare an annual financial report for the partners. The contents comply with the firm's reporting policies to clients and contain an independence qualification, various financial statements and supplemental data. (See chapter 501 of the *MAP Handbook.*) This provides partners with the information they need—data for preparing proposals and for comparisons with other firms.

The opportunities that can be derived from planning are immense. You can get satisfaction, financial rewards and retirement security. Planning is an endless cycle, however. You evaluate one year, only to begin the next. This can be discouraging to everyone.

If the plan is to gain the support of other firm members, there must first be enthusiastic support of it and commitment to it from the top, that is, from the founding partner, the senior partner and the managing partner. The next step is to recognize where problems exist and to reconcile incompatible goals.

We found that when our partners were exposed to other firms' successful planning experiences, this helped gain support for the plan in our own firm. An easy way to get this exposure is at state society or AICPA MAP conferences.

When we compared our statistics with those of other attendees at a MAP conference in 1971, we found we were not very profitable. Inspired to develop a five-year plan, we did not adequately involve all partners, and our first draft was a failure. It was then that we realized that for a plan to succeed, it must have the total commitment of all members of the firm, it must involve them and meet their expectations, and there must be action taken to make it work.

How to write a plan

Chapter 104 of the AICPA *MAP Handbook* contains many ideas on writing a long-range plan, such as format, delegation of responsibility and the like. The plan should always be written down and communicated to personnel; otherwise everyone in the firm will have different ideas as to policies. Basically, the plan should contain a philosophy of practice which covers items such as the following:

- ☐ Quality of practice.
- ☐ Scope of services.
- ☐ Ethics of practice.
- ☐ Size of practice, including the area of service, the industry specialization and the number of offices.
- ☐ Personnel policies.
- ☐ Environment.
- ☐ Attitudes toward professional and public service.
- ☐ Merger philosophy.
- ☐ Admission of partners.
- ☐ Successors to key positions.
- ☐ Profits.

It should also have a section covering firm statistics, ratios and results such as

- ☐ Gross fees per partner, per professional staff, per administrative person, per individual, per chargeable hour and per client.
- ☐ Chargeable hours per partner, per professional staff, per administrative person and per individual.
- ☐ Net income per partner, per individual and per chargeable hour and various related percentages.
- ☐ Capital per partner and percent of gross fees and net income to capital.
- ☐ Personnel ratios—partners to professional staff, partners to administrative personnel and administrative personnel to total personnel.
- ☐ Growth rate—real and inflationary.

In addition, the plan should contain both comparisons based on other firms' data and statistics found in the *MAP Handbook* and a five-year projection.

A long-range plan must be subject to modification. Both opportunities and capabilities change, and firms must adjust to a situation. Some of the reasons for revisions in our plan include the loss of senior partners and the slow development of new ones, and mistakes in judgment. Then there have been unexpected opportunities such as the unusual growth of a new office.

We think continuous planning can offer significant benefits to every practitioner and recommend a definite commitment to planning and control. It means making the necessary decisions and taking the required action, but it also means you can become master of your fate. You have only one life to live, so make it what you want it to be. ☑

—by Charles W. Jenkins, CPA
Albany, Georgia

STRATEGIC PLANNING FOR CPA FIRMS

January 1986

During the last ten years, the profession of accountant has evolved from that of "a person whose job is to examine and adjust accounts" into one that encompasses a broad range of service areas. We have expanded our professional boundaries beyond audit, tax and accounting services to business advice and counsel; tax, estate and personal financial planning services; and much more.

Nonnational firms have, for the most part, allowed these changes to take place without planning for them or evaluating their possible outcomes. In effect, in lieu of participating in engineering our future, we allowed the momentum of the profession to direct it.

Because of economic expansion, population growth, technological changes and a less competitive environment than today's, this metamorphosis took place without substantial negative impact on most firms. Time and circumstances are changing, however. The trend to more firms and more competition will likely continue. To succeed, we will need to manage our future in the fashion we advise our clients to manage theirs. The need for strategic planning is obvious.

The planning process

The first step is to decide on the purpose of the plan. Unless the organization has a set of specific objectives in mind, there is little need to dedicate valuable professional and managerial time to the development of uncoordinated plans. Firms should also be careful about trying to be overly inclusive in the first attempt at strategic planning. To do so is likely to result in chasing too many variables, leading to frustration and the abandonment of the planning process.

Topics for consideration will depend on a number of factors, including firm size, existing portfolio of services, existing and anticipated competition, market area and personal values. First-time planners will probably want to consider the future of existing services, organizational structure, the firm's competitive position and growth potential. These determinations will usually be made by the partnership in a small firm and the executive committee in a larger firm.

Once the objectives have been decided, participants for the planning unit must be chosen. This again will depend on the size of the firm and current organizational structure. For smaller firms with up to five partners, the planning unit will probably include all partners. For larger firms, the planning unit should include those partners responsible for firm direction. In both instances, managers and other senior employees might also participate.

While the planning unit should not put limits on the amount of information it solicits or receives, only key personnel should be members. Having too many people in the planning unit increases the probability of straying from objectives and limits the chance of establishing a workable plan.

To ensure unity of purpose, members of the planning unit should have a clear understanding of the

- ☐ Planning objectives.
- ☐ Time period involved.
- ☐ Use that will be made of the resulting plan.
- ☐ Goals of the firm.
- ☐ Business mission statement.
- ☐ Rules for conducting business.

Before proceeding to the actual planning phase, it is important to determine the firm's current position (very few of us do this). This is typically referred to as the situation analysis or situation audit. The process can be enlightening and is critical to developing a plan to reach defined objectives.

Every product or service offered by any business, whether professional or otherwise, has its own life cycle. We accountants frequently operate under the misconception that the services we offer will be required at current or expanding levels of demand ad infinitum. Given the changes in our social, economic and political environment, however, this premise is often unjustified. We have to prepare ourselves to offer new services in anticipation of their being needed and reduce the emphasis on those services where demand has slackened.

Although at this juncture no planning has yet been performed, even if the process were suddenly terminated, subsequent benefits would still accrue to the firm in the form of a clearer understanding of its rules for doing business and what it is attempting to accomplish. This documented understanding may be helpful when training new supervisors, managers and partners.

A training tool

Typically, we accountants are ill-prepared to assume management positions in the firms for which we work. Up to the time we are promoted to supervisor or manager, our training has been primarily technical in nature. What understanding we have of our firms' objectives and rules for doing business has probably been gained through the osmotic method of trial and error. When value systems, objectives and concepts are formalized in written form, accountants have a head start in making the difficult switch from technician to manager.

Any firm employing a well-written plan in this fashion should be rewarded with substantial savings in costs and time. Instead of making errors, young professionals would be able to review a document that provides them with a basis for making decisions that are consistent with the firm's value system and goals.

Another benefit of the planning system, even if carried only to this point, lies in the increased communication skills acquired by members of the planning unit. Finally, there will be an increased sense of involvement in the organization—an area which we CPAs have historically underrated.

Beginning the planning phase

In determining what future to plan for, the firm should consider the following possibilities:

- ☐ No change.
- ☐ Additional services.
- ☐ Expansion of market.
- ☐ Forward integration—moving toward the ultimate user of the service provided.
- ☐ Backward integration—supplying services which are currently purchased by the firm (e.g., employee benefits).
- ☐ Diversification.

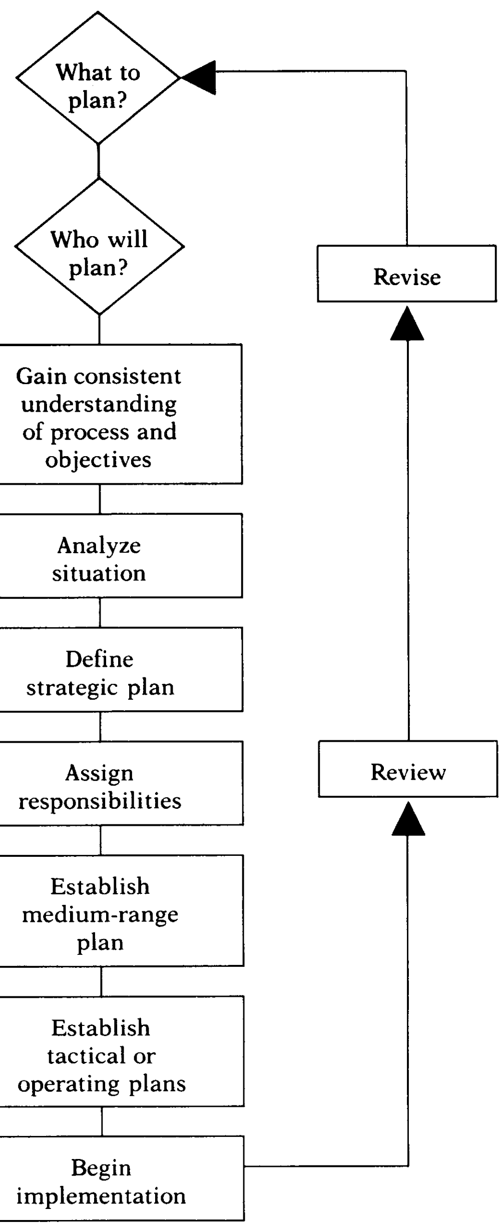
In evaluating potential change, all possible outcomes should be analyzed. One of the advantages of the planning process is that it permits simulation and anticipation of future opportunities. Conversely, the firm might be alerted to possible problems and could then establish plans to avoid or minimize any negative impact.

The key to the simulation process is that it allows the firm to preview the future before committing resources to what might prove to be a costly mistake. Using microcomputers and electronic spreadsheets, today's CPA is able to employ game theory. Planners should not, however, forget the importance of qualitative versus quantitative analysis. In any attempt to analyze the future, an analysis

Further Reading

For practitioners who wish to research further the subject of strategic planning, the following two books are suggested: Steven C. Brandt's *Strategic Planning in Emerging Companies* (Reading, Mass.: Addison-Wesley Publishing Company, 1982) and George A. Steiner's *Strategic Planning* (New York, N.Y.: The Free Press, 1979).

The Planning Process



based exclusively on quantitative factors lacks the crucial component of entrepreneurial insight.

Once the rough draft of a strategic or comprehensive plan has been developed, it shoud be reviewed with members of the firm who are not part of the planning unit. This will help to assure that perspective is maintained in formulating organizational goals. Once this phase has been satisfied, medium-range and tactical plans can be established.

If not set up as a continuing process, the strategic plan could become outdated as objectives and conditions change. Before the plan is formalized, responsibility should be assigned to an individual (preferably a partner) to assure that it will be reviewed and updated at least once a year and preferably every six months. Then a date should be set for the next meeting of the planning unit. Another important point is that the firm's top management must be committed to the plan and directly involved in the planning process if the probability of its success is not to be substantially reduced.

Management must also create an environment which is conducive to the free flow of ideas, so that important items will be considered. One way to accomplish this is to conduct planning sessions at informal locations away from the day-to-day pressures of the office environment. In addition, all participants should be held in equal regard—that is, each individual's ideas should be given the same consideration without regard to seniority or position.

In instances when it is the firm's initial attempt at strategic planning and little prior planning experience exists, it may help if someone outside the firm is involved. This individual should be well versed in strategic planning and have experience in planning, preferably within the profession. The purpose is to

- ☐ Provide an objective look at the profession and the firm.
- ☐ Assure that all participate equally in the exchange of information and ideas.
- ☐ Assist the planning unit in reaching its objectives by not pursuing unrelated variables and issues.
- ☐ Attack the fundamental questions of what the firm is attempting to accomplish and determine its rules for doing business (including risk assumption, ethics, morals and personal values).

Another potential pitfall to be avoided is the failure to communicate the plan effectively to those who will be responsible for executing it. If any partners or staff members are not aware of the plan's objectives, it will be difficult for them to make decisions that are consistent with it. To prevent this from happening, consider making the plan a document that is available to and is discussed with everyone in the firm.

Once the plan is adopted, the firm should make certain that day-to-day decisions are consistent with it. To do otherwise will destroy the plan's credibility and cause confusion among partners, staff and support personnel. ☑

—by Gary S. Nelson, CPA
Bend, Oregon

PLANNING AND PROFITABILITY

December 1988

Attending management of an accounting practice conferences is a great way to share information and ideas with practitioners from around the country. Participants can ask questions and find out how others solve problems and run their practices. The following questions were asked at various AICPA MAP conferences. Our editorial advisers respond.

Is there a special way to plan for growth—to double revenue in five years, for example?

Richard A. Berenson, a New York City, practitioner, says that a doubling of revenue in a five-year time frame would take a major marketing campaign. Prior to any new-client efforts though, he says, the first step should be to strive to increase revenue from present clients. In addition, all members of the firm would need to be made aware of the growth goals because such a marketing program would require everyone's cooperation. Another essential ingredient, according to Mr. Berenson, would be a monitoring capability to enable the managing partner to review results on a periodic basis.

Predicting such revenue growth is difficult. Abram J. Serotta, who practices in Augusta, Georgia, says that the planning process would need to include a staff plan so that you can service the increased revenue. He asks, "How many CPA firms hire additional staff in excess of their needs before tax season?" If a firm is to grow during tax season (the most likely time that clients switch), says Mr. Serotta, the firm must have staff. Mr. Serotta thinks that once you have a staff growth plan in place, you are then in a position to discuss marketing.

One idea Mr. Serotta suggests might be to assign a quota each month to obtaining five new corporate clients generating, say, between five and ten thousand dollars each. The quotas and goals will help in the efforts to double revenue. Mr. Serotta says this should be in addition to activities aimed at increasing revenue from present clients.

Robert L. Israeloff, a Valley Stream, New York, practitioner, says that when planning growth, it is important to plan for increased profits, as opposed to merely planning for doubling revenue in a certain time frame. He says it may be nice to budget the increased revenue in an orderly manner, but it may not be practical. Certain things may happen that are beyond one's control. Nevertheless, if revenue projections cannot be met, then certainly expenses can be controlled.

There is no magic formula, though. Instead, Sidney F. Jarrow, an Elmhurst, Illinois, practitioner, believes in management by objectives and firm commitment. To increase profits, he says, bill aggressively and not defensively. Find new marketing niches and sell present clients additional services they can use. To reduce expenses, he advocates using labor more effectively.

H.W. Martin, a retired practitioner from Rome, Georgia, also doubts that there is a special way to plan for such growth. He says that there are many factors that change a business over a five-year time span, such as the countless mergers that have involved local accounting practices, to make such planning impossible. Long-range planning for nebulous goals is not practical, he says, but such planning is necessary for events that will happen, such as every partner leaving at some time.

Mr. Martin recommends that CPAs spend more time on short-term planning for today, tomorrow, and next week. Doing a good job with your present time will assure a better future, he says.

What are the critical factors to monitor?

Mr. Jarrow suggests looking at write-downs and write-ups, profits before partners' salaries, gross billings per partner and per employee, then at gross profit per partner and per employee.

Mr. Israeloff says that the key fact or statistic to be monitored regularly is the percentage of chargeable time of staff and partners. This statistic still reflects the "bread and butter" of our profession, namely, the utilization of our people, he adds.

Mr. Israeloff suggests that if staff members get below seventy-five percent chargeable, start looking at their activities and productivity. He says there may be good reason for the lower chargeable time, such as practice development or state society activities, but the percentages must be recorded. If a line partner falls below sixty percent chargeable time, then, he says, the managing partner must investigate.

What percentage should net income and staff salaries be of gross billings?

Mr. Israeloff believes that staff salaries should not exceed thirty-five percent of gross billings. He includes all salaries, professional and administrative, and says that Israeloff, Trattner & Co. aims for thirty percent, and also targets forty percent net income.

Mr. Berenson thinks staff salaries should be approximately thirty-five to thirty-eight percent of revenue, and suggests thirty to thirty-three percent for net income.

Focusing on a percentage of gross billings for net income and staff salaries can be dangerous, though, according to Mr. Serotta. Each firm is different, he says. For instance, the number of partners to staff will affect the amount of net income. If a firm takes in a partner before achieving billing criteria, then obviously its net income per partner will be less. This may be done because the firm is young, or because the partners desire to recruit and retain staff by advancing people to partner at a faster pace than other firms.

Mr. Serotta says that staff salaries as a percentage of billings probably run between thirty and thirty-seven percent. This again is affected by the type of practice and the partner/staff ratio. If there are few partners doing productive work, staff salaries may be higher. If, on the other hand, there is a substantial number of productive partners and few staff, the salary percentage would be lower. Also, keep automation in mind, he says. Progressive firms that make full use of the latest computer auditing and tax packages should find that salaries are a smaller percentage of their total billings than firms that are less automated. ☑

Section 5

QUALITY AND ADMINISTRATIVE REVIEWS

MANAGING THE FIRM FOR QUALITY CONTROL

July 1990

There is a definite correlation between the quality of management of a CPA firm and the quality of the professional services it renders. As a result, a sloppily run firm may be more likely to perform poor work for its clients.

This is not to suggest that efforts to control quality do not exist in less well-run firms. After all, every CPA firm has a quality control plan of one sort or another. The plan may not be well defined and may even consist of an informal understanding about review of work performed. However, if effective and uniform quality control is to be attained, what is needed is for a CPA firm to operate as a firm and not simply as a group of individual practitioners. Every firm should be moving toward having written review procedures and a fully documented control plan.

In order to set up a quality control plan, it is necessary to study the firm's structure. The size of the firm, the number of offices, the present quality control procedures for each office (whether existing or planned) and whether or not quality control is (or will be) centralized are all factors which should be taken into consideration in developing a documented quality control plan.

Quality control should be organized in the same way as other firm functions are organized. For example, if the firm has functional committees, the quality control function should be assigned to a committee.

Developing a quality control plan

Drastic changes in existing policies and procedures may not be necessary in developing your firm's quality control plan. However, if changes are needed, this is the time to make them. You may find that all that is needed is to express existing policies and procedures in writing. For guidance, sample quality control documents can be found in the AICPA *Accounting and Auditing Manual.*

Remember though, that what works well in one firm may not work in another and that any plan must be appropriate for a particular firm. So, if you use sample quality control documents or have access to other firms' quality control documents, don't adopt them for your firm without thorough study, review, and amendment. Even though firm policies should meet professional standards, they should not be unnecessarily rigid, and the objectives expressed in these policies must be attainable or the plan will ultimately be disregarded and will fail.

Here are some suggestions for those people responsible for developing the firm's quality control plan. Consider each of the nine elements enumerated in Statement on Quality Control Standards no. 1, *System of Quality Control for a CPA Firm,* and ask

- ☐ What are we doing now?
- ☐ What should we be doing?
- ☐ What forms and records shall we need to demonstrate our adherence to the policies?

Write a concise description of the plan for each of the nine elements stating the policy and how adherence to the policy is to be documented.

Gaining acceptance of the plan

There is likely to be some resistance to the formalization of policies and procedures, particularly on the part of partners who may operate more or less on their own and who visualize a threat to their independence. Also, there may be some partners and staff members who believe such a plan is a restriction on the exercise of their professional judgment.

Much of this resistance can be overcome by stressing the necessity of uniform firm policies and by pointing out the dangers that can arise from having some members of a firm set standards which are not followed by all.

It is a good idea to seek the advice of partners and others in the firm by bringing them into the process even though responsibility for developing the plan has been delegated to one partner or to a committee. But don't expect total agreement on the plan, and certainly do not postpone its adoption in the hope of getting unanimous agreement on all of the plan's provisions.

If the firm has been loosely structured with each partner having substantial autonomy, there will probably be more resistance to the plan than would be the case in a more structured environment. A general reorganization of a loosely structured firm may be in order at the time the quality control plan is being considered.

A quality control plan is a commitment and, once adopted, it should be followed. (The plan should include procedures for determining whether or not it is being followed.) Bear in mind that no plan is unalterable, and every plan should be reviewed periodically and amended when appropriate. For a quality control plan, amendments may be necessitated by changes in the firm's size or in the nature of its clientele, or by other factors such as changes in professional standards. Or again, amendments may be required when experience suggests that other ways will make the plan work more effectively.

On-site peer reviews and quality reviews are a means of assuring that your quality control plan is doing the job it is designed to do. The reviewers will check to see that the plan is suitable for your firm and test it against professional standards. They will also make sure that the plan is being followed.

Formalization of a quality control program can be of great help in turning up potentially embarrassing

Exhibit 1

Quality Control Materials

	Independence	*Assigning personnel*	*Consultation*	*Supervision*	*Hiring*	*PD*	*Advancement*	*Acc. & cont. of clients*	*Inspection*	*N/A**
Audit manual			X	X						
Accounting manual			X	X						
SEC manual			X	X						
Tax manual										X
MAS manual										X
Personnel manual	X				X	X	X			
Personnel files		X			X	X	X			
Billing and collection records	X							X		
Professional library	X		X			X				
Technical checklists				X						
Internal control questionnaires				X						
Audit programs				X						
Sample engagement letters				X						
Pro forma certificate of minutes and representation letters				X						
Sample legal letters				X						
Sample management letters, financial statements and auditors' reports				X						
Engagement time budgets		X		X			X			
Engagement time analyses		X		X			X			
Time and expense reports		X		X			X			
Monthly/quarterly staff schedules		X								
Annual schedules of projected hours for professional staff		X								
Report review procedures				X						
Reviewer's checklists				X						
Reviewer's memoranda				X						
Second partner review procedures, checklists and/or memoranda				X						
Planning memoranda for engagements				X						
Memos in workpapers summarizing significant audit conclusions				X						
Recruiting brochures and letters					X					
Employment applications					X					
Interview evaluation forms					X					
Staff evaluation forms		X								
Partner evaluation forms		X								
Client lists	X									
Client permanent files and correspondence files								X		
Independence confirmations	X									
Records of attendance at professional development courses						X				
Training manuals						X				
Profile sheets/checklists for new clients								X		
Forms for reimbursement of membership dues in professional organizations						X				
Forms for reimbursement of review course for CPA exam							X			
Post-issuance report checklists									X	
Written inspection programs									X	
Written inspection reports									X	

*Relates to tax and MAS segments of practice and should not be included in quality control document.

Exhibit 2

Steps in Conducting an Audit Engagement

	Independence	*Assigning personnel*	*Consultation*	*Supervision*	*Hiring*	*PD*	*Advancement*	*Acc. & cont. of clients*	*Inspection*
1 Engagement partner prepares engagement letter and requests staff for the engagement. Submits estimated timing for engagement.		X		X					
2 Staff (manager, in-charge and assistants) assigned to engagements based on experience, independence, past evaluations and time availability.		X			X	X	X		
3 Staff reviews permanent files, workpaper files, correspondence files and prior year's financial statments, audit report and management letter.				X					
4 Preplanning meeting with engagement partner.				X					
5 Planning conference with client.				X					
6 Manager/in-charge prepares detailed planning memo and time budget.		X		X					
7 Commencement of interim field work:									
Evaluation of internal control				X					
Compliance tests				X					
8 In-charge discusses progress of work and any engagement problems with staff.				X		X			
9 Review of interim workpaper files by in-charge				X					
10 Interim performance evaluation of staff.		X					X		
11 Year-end work:									
Substantive tests				X					
Conclusion memoranda				X					
Legal letters				X					
Representation letter				X					
Certificate of minutes				X					
Draft of financial statements, opinion and management letter				X					
Disclosure checklist				X					
Time summary and analysis		X						X	
12 Throughout engagement, in-charge monitors the staff's work.				X		X			
13 In-charge and manager review workpapers, report and management letter. Initial all workpapers as evidence of review.				X					
14 Staff clears all review notes.				X					
15 Engagement partner reviews workpapers, report and management letter. Initials covers of all workpaper files and permanent files, report and management letter as evidence of review.				X					
16 Staff clears engagement partner review notes.				X					
17 Consultation with industry specialist on reporting problem.			X						
18 Resolution of problem. Documentation of resolution by engagement partner.			X						
19 Second partner review of report. Reviewer's checklist completed. Initials report.				X					
20 Report and management letter submitted to report department. Before report is processed, it is checked to see that two partners have approved it.				X					
21 Report and management letter typed and proofread. Report also checked for mathematical accuracy.				X					
22 Engagement partner signs report and management letter and submits them to client.				X					
23 Final staff performance evaluations.		X					X		
24 Billing of client. Collection of fees.	X							X	
25 Workpaper files and copies of the report and management letter sent to file department. Notification to managing partner that engagement was completed and available for in-house inspection.									X

situations and, of course, having a plan provides discipline. It give a higher degree of assurance that those within the firm do not overlook or bypass procedures which should be carried out. But probably the most important point is that having a quality control plan will help everyone in the firm do a better job and that, in the long run, will be profitable both for the CPA firm and for the client.

—by **Samuel A. Derieux, CPA,** *Deloitte & Touche, 700 E. Main Street, Virginia 23219*

Editor's note: The above article is basically a reprint of Mr. Derieux's article of the same title that was published in the July 1980 issue of the Practicing CPA. *Updated where necessary to reflect current professional standards, its message of commitment to quality control remains the same.*

PLANNING FOR QUALITY REVIEW

June 1990

When someone mentions quality review, how do you react? Perhaps you experience a twinge of nervousness, or maybe even fear grips you. If so, you are having a normal reaction, particularly if you have never had a review before.

I am the managing partner (we use the term *chief executive officer)* in a small, northern Louisiana firm which has three principals, and three professional and two administrative staff—a total of eight people. Together, we have been planning for our quality review, and have had similar reactions to those described above. We have had to look carefully at the services we provide clients, and we have had to make some tough decisions.

Decision number one

The first question we had to answer was whether we wanted to be a full-service firm with audit clients. I realize that it isn't unusual for smaller firms to question the extent of their audit services, and to look for ways to specialize and develop profitable niches. Nevertheless, it is always a tough question to answer. Forty percent of our firm's revenue comes from audit clients. Therefore, we decided we needed to remain full service. This was a qualified decision, however.

We decided we would no longer take on all types of accounting and auditing work. In particular, we decided that we would not do work for SEC clients. The SEC area was particularly important. When we compared the additional quality control requirements with the amount of SEC work that we did, such engagements simply made no sense for our practice.

With this decision, we had to make other arrangements for our SEC clients. Fortunately, we have been able to set up "sharing" relationships with several other firms which do SEC work. Written assurances that the client will not be stolen from us were prerequisite to these arrangements.

There is a flip side to these sharing agreements. We have been approached by smaller firms to do non-SEC audit work for their clients, while they retained other practice areas. To date, all of these arrangements have worked exceedingly well.

I would hesitate to offer blanket advice to other firms faced with similar decisions. The choices are difficult. Nevertheless, there is a definite cost-benefit ratio that can be quickly computed. For us, it was more cost effective to limit the financial review work in our practice.

Easing the fear factor

After deciding to stay with audits, our next move was to get as much information as possible on what a quality review would be like. Our top priority was to take the mystery out of the process.

We sent two of our firm principals to the Louisiana Society's *Preparing for Peer Review* course. To get the scoop from the other end of the process (to learn exactly what a reviewer would be considering), I attended a *How to Conduct a Peer Review* session. The knowledge we gained greatly eased our fear factor.

Our control document

Next, we chose one member of our firm to write our quality control document using the nine quality control elements described in Statement on Quality Control Standards no. 1. Now I realize that it is not necessary for a firm to have a quality control document, but we thought it important because of the amount and variety of audit work we perform in our practice. We are also aware that control documents can be purchased and adapted for use in one's own firm. But, we chose not to buy one.

We preferred to start from scratch because this would force us to think. While thinking takes time and commitment, it reinforces the importance of the process.

I must confess that we did not literally start from scratch. Besides taking notes at our CPE courses, we used the *Guide to Quality Control* issued by Practitioners Publishing Company. We kept our document simple. It contains only the minimum policies and procedures to meet the minimum standards. This allows flexibility later on, because once a procedure is written in your document, you are obligated to follow it precisely.

When the first draft of the quality control document was written, all aspects were discussed by firm principals, changes were made, and a second draft was circulated to all staff for comments. These comments were considered, and two weeks later we had our document.

Beefing up the library and rethinking CPE

Another decision we made was to increase the number of resources available in our accounting and auditing library. We now have the FASB looseleaf service, the *Miller Guides* (all three), and almost all the guides and manuals issued by the Practitioners Publishing Company. Our budget for accounting and auditing publications is now as large as the one for tax references.

Because we do government audits, the majority of our CPE is in the accounting and auditing area—and it's a lot. Under the *Government Auditing Standards* issued by the U.S. General Accounting Office (the Yellow Book), all three principals and the three accounting staff members must have eighty hours of CPE by January 1, 1991, with twenty-four hours in government accounting and auditing. On top of that, we still need to keep up with tax issues.

CPE comprises one of the largest costs with which we are grappling. Not only are the costs high in terms of budgetary dollars, but they are also high in terms of travel and nonbillable hours.

So, how are we handling it? Well, we haven't got all the answers, but we are pursuing the problems. We do know some of our options. These are to encourage more applicable CPE at the chapter levels, pursue in-house CPE, and to share in-house planning and teaching with some other firms.

We also made some decisions about our administrative procedures. Here is a quick summary.

- ☐ We created checklists for audits, reviews, and compilations.
- ☐ All audit and review reports must be checked by a second principal before they are released.
- ☐ Our hourly rates for audits and tax services will remain the same, even during slow seasons.

With all this thinking about our practice, we have also considered our future. We thought about merging with a larger firm, but decided to stay as we are for the present time. We do plan to become participants in our state society appointed review teams, although it will be a year or so before we become involved.

Slaying the QR dragon

As a final step in planning for our quality review, we decided to take a trial run—to have a consulting review. We thought this would remove any lingering kinks in our program, rid us of nervousness, and be a way to finally slay the QR dragon.

We had the consulting review in October, last year. It went well. One of our partners had met someone from a large local firm in Jackson, Mississippi, when taking a CPE course in that city. We thought that Jackson was far enough away from Monroe to safeguard against competition but close enough to keep travel costs from being excessive, and decided to ask the firm to conduct our consulting review.

The AICPA Consulting Review Program

The consulting review the firm of Perry, Parker and Powell found invaluable in assuaging fears about its upcoming quality review (see "Planning for Quality Review," page 1) is an AICPA program designed to help local firms improve the quality of their practices.

Consulting reviews are educational in nature and are conducted on the reviewed firm's premises by an experienced reviewer selected by the organization administering the program. During the visit, the reviewer obtains an understanding of the firm's system of quality control by interviewing appropriate firm personnel and by completing a questionnaire.

This is followed by a discussion of the firm's responses to the reviewer's questions and, perhaps, by the reviewer dealing with specific quality control problems raised by the firm. The reviewer also performs a limited review of selected reports, accompanying financial statements, and working papers for each type of service (audit, review, and compilation) that the firm performs.

For many firms, the attractive aspects of this program are that it is confidential, risk-free, and inexpensive. The results of the review, including any suggestions for improvement, are discussed orally at its completion. No written notes pertaining to the review of the firm's records are retained by the reviewer or by the administering organizations. The reviewer's comments are offered for the firm's consideration and are subject to its professional judgment and evaluation in making use of them.

For firms with up to about twenty professionals, the review involves one reviewer for one day and costs $500 plus expenses. For larger firms, the review may take longer and cost proportionately more.

For more information about the consulting reviews contact your state society or Raymond Lipay at the Institute: (212) 575-5477.

First, we made sure that our firms do similar work. This is an important element of the consulting review program. We wanted to be sure they would provide us with a knowledgeable assessment based on the specific type of work we perform.

We were ready with a list of questions and five sets of different engagement workpapers and reports when the consultant arrived on the Monday morning. After a briefing on our practice, the consultant answered our questions for two hours. Most of these were related to our documentation. We wanted to be sure we had the correct documentation for all of our different types of engagements.

After lunch, the consultant reviewed our quality control document, workpapers, and reports. Overall, we were in good shape. More important, though, besides offering some helpful suggestions about strengthening quality control, the consultant was able to ease our minds about our upcoming quality review. At $500, plus the cost to the consultant of travel and lost billable time, it was well worth the investment.

Now that you have a taste of what quality review planning entailed at one local firm, you might wonder whether the program is really that beneficial. My response is, absolutely. As a client said, a short while back, "If it were an easy profession, everyone would be in it." Lucky for us, everyone is not. ☑

—by **Rowland H. Perry, CPA,** *Perry, Parker & Powell, 1209 Royal Avenue, Monroe, Louisiana 71201*

Editor's note: "Planning for Quality Review" is based on an article that appeared in the August–September, 1989, issue of Lagniappe, *a publication of the Society of Louisiana CPAs. We are grateful to the society for permission to use this material.*

HOW TO GET READY FOR QUALITY REVIEW

April 1989

Over 36,000 firms and sole practitioners are currently enrolled in the quality review program that was established as a result of one of six proposals in the Plan to Restructure Professional Standards endorsed by the AICPA membership in January 1988. All practices are urged to join that program or the division for CPA firms if they have not already joined one of these practice monitoring programs.

Initial reviews will be phased in over a five-year period according to firm size and nature of practice. Starting with a pilot program in 1989, firms with at least ten professionals (CPAs and individuals expected to seek that status) will be reviewed first, followed by smaller firms, and then sole practitioners.

The intent of the program is to help firms improve the quality of their practices. Some firms are wondering if there are some steps they can take now that will not only help them prepare for a review, but which might also result in some immediate benefits. Experience with the peer review program of the division for CPA firms suggests that this is indeed a possibility. Several articles in the *Practicing CPA* have described how firms gained from the actual planning and preparation needed for their peer review. (See "Growth Pains and Management Action" in the February 1989 issue and other articles under Quality Control in the subject indexes in the June 1986 and June 1988 issues.)

The approach to the quality review program is educational. For example, if a deficiency is found, the corrective action suggested would probably include ideas for CPE and appropriate changes in the firm's quality control system. In this regard, the Institute is providing the following tools to help firms get ready for their initial reviews. These are tools that could also result in immediate benefits.

Continuing professional education

A new CPE course, "Preparing for Review: Maintaining Quality Control," available in self- and group-study formats, and designed to help firms evaluate and strengthen operating and quality control procedures and policies, includes easy-to-use forms, checklists, and other documents that all local firms can use. While focusing on accounting and auditing, the course also offers information on administration, tax, and other areas. The intended outcome is to improve the quality of the firm's work as well as prepare it for review.

The cost of the self-study course (8 hours of CPE credit) is $99. To order (product no. 749013), contact the AICPA order department: 1-800-334-6961; in New York State, 1-800-248-0445.

Confidential consulting reviews

Training is good, but it can still be reassuring to get an outside opinion of your quality control methods prior to review. The AICPA and participating state CPA societies offer such a program—confidential consulting reviews—for firms preparing for a peer review or a quality review.

In these "trial run" reviews, a reviewer who has experience relevant to your firm will come in for a day, help pinpoint weak areas, and give advice on how to improve them. Preparing for this risk-free, no report review is simple. You merely complete a brief quality control questionnaire, submit it to the reviewer, and select certain engagements for review.

The reviewer meets with you and key personnel to gain a general understanding of the firm, its type of practice, and quality controls, and then conducts a "high spot" review of the working papers, financial statements, and reports you have provided. He or she then holds an exit conference to comment on your work and offer suggestions, if necessary, for improving it and your quality controls.

To ensure confidentiality, you keep all written material developed during the review. You also receive a one-page form on which to evaluate the review, and mail this to the AICPA.

For more information about the consulting review program, please contact your state society or Raymond Lipay at the Institute: (212) 575-5477.

What you can personally do

In addition to using the tools provided by the Institute, there are other steps you can take to get the firm ready for quality review. Some of these will involve the quality control system you probably already have in place.

The first step is to gain an understanding of the nine elements of quality control by reading *Statement on Quality Control Standards No. 1*, issued by the AICPA quality control standards committee. You should then accumulate any written policies, procedures, and standardized forms and checklists you use in connection with your accounting and auditing practice and the nine elements of quality control. Based on the information you have accumulated and your knowledge of the firm, you should then summarize your current quality control policies and procedures as they relate to the nine quality control areas. You won't need a formal quality control document. You can just fill out a brief questionnaire such as the one that is used by the division for CPA firms or the one just developed by the AICPA quality review executive committee.

It would probably be a good idea to conduct an inspection—an internal review—to see how well you are complying with your quality control system and with professional standards in your engagements. Sole practitioners can conduct their own inspections or might want to trade places with another sole practitioner.

Your next step should be to evaluate whether your policies and procedures need to be changed. For example, if you find disclosure and reporting problems, you might decide to start using a disclosure and reporting checklist on all engagements, or require someone who is not otherwise associated with an engagement to review the report and financial statements on the engagement before the report is issued.

You will need to determine whether to develop new quality control materials internally or whether to purchase them. Make sure you tailor any purchased material to your firm's specific needs.

Obviously, if your firm is to benefit from getting ready for quality review, the quality control system must be supported and followed by everyone in the firm—from the managing partner to the junior members of the staff. These efforts will be well worthwhile. For one thing, improved quality will help stem the widening exposure to third-party lawsuits and their attendant costs. Also, the process of getting ready will ensure that the firm is working as efficiently and effectively as possible in providing quality service to clients. Both firm and clients will profit from that. ☑

—*by* **Dale E. Rafal, CPA,** *AICPA, New York*

HOW TO GET READY FOR QUALITY REVIEW (PART 2)

September 1989

My article in the April issue of the *Practicing CPA* covered some of the steps firms can take to get ready for quality review. Knowing what sort of problems you might run into during a review can also be helpful. Because the quality review program is new, we cannot be certain what the problems might be. We do know the types of problems uncovered in the peer review program of the division for CPA firms, however, and they should serve as indicators of likely pitfalls awaiting unprepared firms.

The problems fall into two broad categories. The first relates to the elements of quality control other than supervision. These include

- ☐ How independence questions were resolved.
- ☐ How compliance with independence requirements is monitored.
- ☐ Whether consultation took place when needed and whether it was acted upon.
- ☐ Little or no CPE on accounting and auditing matters.

Lack of documentation in these areas can sometimes cause serious problems. Not obtaining staff independence confirmations, for example, or failing to document independence considerations have led firms to issue audit or review reports on clients where the firm was not independent.

Similarly, substandard financial statements can often be traced to a failure to consult in a complex or unknown area. And when consultation on an accounting or auditing matter is undocumented, there is no evidence for you or the reviewer that all the important facts were considered in reaching a decision. It is, therefore, preferable that you summarize who you called, what you asked, the answers received, and the conclusions reached.

Many small practitioners attend a lot of tax and management courses but neglect CPE on accounting and auditing matters. In these instances, reviewers have found that the practitioners have not stayed up-to-date on accounting and auditing matters and, as a result, substandard auditing and accounting engagements have been performed and improper reports have been issued.

The second category encompasses difficulties relating to the supervision of engagements in the auditing, reporting, and accounting areas. Auditing deficiencies uncovered in the peer review program include situations where there have been inadequate or nonexistent audit programs and inadequate or nonexistent client representation letters. People tend to think they don't need client representation letters on audit engagement when they have been doing business with a client for twenty-five years or more. This is not true! You still need them.

Other common problems noted on audits include inadequate or nonexistent legal letters, no confirmation of cash receivables or debt, and inadequate or nonexistent roll-forward procedures performed when inventory is observed or when receivables are confirmed at an interim date.

Some of the reporting, accounting, and disclosure deficiencies that have been found include reference to supplementary data absent from the report, inadequate or nonexistent disclosure of related-party transactions, inadequate or nonexistent pension plan disclosure, inadequate lease or tax disclosures, no disclosure of five-year debt maturities as required by Statement of Financial Accounting Standards no. 47, and improper classification of debt according to SFAS no. 78.

Another problem that smaller firms, particularly, have had in their peer reviews relates to a failure to have adequate documentation in the area of planning. Often memoranda and other types of documentation normally present in working papers concerning planning considerations are missing. Reviewers have also frequently found that working papers do not show evidence of being reviewed. Other problems have included failure to document the application of analytical procedures, audit risk and materiality considerations, and considerations of audit sampling.

Finally, in the Statements on Standards for Accounting and Review Services area, we have noted numerous problems with computer-prepared compilations such as reports that do not state the period covered or that do not reflect the titles on financial statements improperly classified short-term portion of a long-term debt, and accruals that are not made on interim compilations and a failure to report these in the compilation report.

You can prevent the likelihood that you will make the types of deficiencies noted in this article with a commitment to quality, proper training of yourself and your staff, and by using practice aids and other quality control materials developed internally or purchased from external sources, such as the AICPA. ☑

—by **Dale E. Rafal, CPA,** *AICPA, New York*

Editor's note: Ms. Rafal is vice president–quality review at the Institute.

WHAT AN ON-SITE QUALITY REVIEW ENTAILS

April 1990

One of the major requirements for membership in the AICPA is that a member active in the practice of public accounting must be associated with a firm that is enrolled in an approved practice monitoring program—the private companies and the SEC practice sections and the quality review program.

A requirement of each of these programs is that the firm have a review of its accounting and/or auditing practice once every three years. Under the quality review program, a firm that performs audit engagements must have an on-site quality review; a firm that performs accounting engagements, such as reviews or compilations, but performs no audit engagements, may have an off-site review.

The review team that performs a firm's on-site quality review can be formed by another member firm that it engages (a firm-on-firm review), an authorized association of CPA firms to which the firm being reviewed belongs (an association review), or the entity—either the state CPA society or the AICPA—administering quality reviews in its state (a committee-appointed review team or CART).

An on-site review will include

- ☐ A study and evaluation of the quality control policies and procedures that the firm being reviewed had in effect for its accounting and auditing practice during the period under review.
- ☐ Testing of the reviewed firm's compliance with its quality control policies and procedures by
  - (1) Inspecting each organizational and functional level within the firm.
  - (2) Reviewing selected engagements, including working paper files and reports.
- ☐ Interviews with firm professional personnel.

The review normally covers a one-year period mutually agreed upon by the review team captain and the firm under review. Engagements selected for review would be those with years ending during the year under review, unless financial statements covering a more recent year have been issued. The on-site review period ordinarily must not end before the end of the previous calendar year.

The review will cover the professional aspects of a firm's accounting and auditing practice. For purposes of quality reviews, this is limited to all auditing, review, and compilation services covered by Statements on Auditing Standards, Statements on Accounting and Review Services, Statements on Standards for Accountants' Services on Prospective Financial Information, and standards for financial and compliance audits contained in Government Auditing Standards issued by the U. S. General Accounting Office. Other segments of a firm's practice, such as providing tax services or management advisory services, are not encompassed by the scope of the review except to the extent they are associated with financial statements, such as reviews of tax provisions and accruals contained in financial statements.

The review team will request background information on the firm being reviewed such as

- ☐ A completed quality control policies and procedures questionnaire.
- ☐ A copy of any manual, checklists, or forms used on accounting or accounting engagements.
- ☐ A list of accounting and auditing engagements for the year under review, showing the type of client (audit, review, or compilation), the industry in which the client practices, and the management-level staff servicing the client.
- ☐ A list of the firm's professional personnel, showing name, position, and years of experience with the firm and in total.
- ☐ Documentation of the firm's compliance with its quality control policies and procedures, including independence confirmations, personnel files, CPE records, and documentation regarding consultations with outside parties.

The review evaluates whether the quality control policies and procedures met the objectives of quality control standards established by the AICPA (see Statement on Quality Control Standards No. 1, *System of Quality Control for a CPA Firm)* and whether they are being complied with in order to provide the firm with reasonable assurance of conforming with professional standards.

Following the review, senior members of the reviewed firm should attend an exit conference at which the team captain will discuss the review team's findings and recommendations and the type of report it will issue.

Within thirty days of the exit conference, the team captain will prepare and issue a written report on the results of the review and, if applicable, a letter of comments. The reviewed firm will then have thirty days in which to review these documents and submit a copy of them to the entity administering the firm's review along with a written response to the letter of comments outlining the actions the firm plans to take with respect to the recommendations made by the review team.

A duly constituted committee of a participating society or the AICPA Quality Review Executive Committee will then evaluate the results of the review. This will include an evaluation of the adequacy of the corrective actions the firm has represented it will take and a determination on whether other remedial, corrective actions and/or monitoring procedures of the firm's action plan should be required. Quality in the performance of accounting and auditing engagements by AICPA members is the goal of the quality review program. The program seeks to achieve its goals, when necessary, through education and remedial action. ☑

—by **Dale E. Rafal, CPA,** *AICPA, New York*
Editor's note: Ms. Rafal is vice-president–quality review at the Institute.

HOW TO SELECT A FIRM TO PERFORM YOUR REVIEW

February 1990

If your firm is planning its initial peer or quality review, you are probably wondering who should perform it. There are a number of alternatives available, including a review by a team

- ☐ Appointed by the AICPA or a participating state CPA society (a committee-appointed review team or "CART").
- ☐ From another member firm (a "firm-on-firm" review).
- ☐ Formed by an authorized association to which your firm belongs (an "association" review).

To have another firm perform your review, you must first understand the qualifications that a firm and its review team must possess. Then you must select a suitable firm that meets these criteria.

Qualifications of firms and review team members
Your firm is responsible for determining that the reviewers you engage meet the basic qualifications set forth in the standards governing the program under which your review will be performed. This reference check is necessary to avoid questions later about the conduct of the review or the qualifications of the team members.

Generally, the standards require that a reviewer must be a member of the AICPA, be licensed to practice as a certified public accountant, possess current knowledge of professional standards and the industries in which the reviewed firm practices, and be a partner or manager in a firm enrolled in an approved practice-monitoring program with at least five years of experience in the accounting or auditing function. Additional qualifications are set forth in the standards governing the peer review and quality review programs. (See pages 2–10 and 2–11 of the *PCPS Peer Review Manual* and *SECPS Manual*, and paragraphs 17 through 21 of the *Standards for Performing and Reporting on Quality Reviews.)*

Identifying firms to perform your review

The first step in the process is to identify some firms you would like to have perform your review, and then to investigate their backgrounds, suitability, and experience. If you do not know any such firms, your state CPA society can supply you with a list of candidates located in the geographic area you specify that are interested in performing reviews of other firms. Also, the private companies practice section (PCPS) executive committee publishes an annual *Firm-on-Firm Directory*. The 1989 directory can be obtained free of charge from the AICPA order department (product number G005169).

Background of the firm

To make sure you select a qualified review team, it is necessary to check the backgrounds of firms identified as possible candidates. You may ask them to mail you pertinent information, including copies of their most recent peer or quality review reports, letters of comment, and letters of response. You might also request résumés of the partners and managers who do reviews, as well as detailed information about the types of clients the firms serve.

You should determine whether the firm received an unqualified opinion on its own most recent review. If your firm (the "reviewed firm") is a member of the SEC practice section (SECPS) of the division for CPA firms, the most recent peer review of the selected firm should have been performed in accordance with the SECPS peer review standards and accepted by the SECPS peer review committee. If your firm is a member of the PCPS only, the most recent peer review of the selected firm should have been performed under the auspices of either the SECPS or the PCPS peer review committees. If your firm is enrolled in the quality review program, the selected firm need not have been reviewed or have received an unqualified opinion until January 1, 1992. If the team captain's firm has had a quality review or a peer review before that date, however, the report on the review must be unqualified.

You will also want to check the letters of comment and the responses of the candidate firms. These documents often reveal a great deal about a firm's quality.

You might also compare the type and size of the team's practice unit to your own practice, because these characteristics may have an effect on the review's efficiency and effectiveness. A reviewer from a slightly larger firm (or one who has been with a larger firm, for example) may be helpful in providing insights into problems you may encounter as your practice grows.

Experience of the review team

The next step in the selection process is to learn about the experiences of the firms you have identified. You should, of course, consider whether each firm has the necessary experience in your special practice areas and in your clients' industries. If your primary clients are construction contractors, for example, you do not want the reviewing firm to send a banking expert. If you have SEC clients or clients in a specialized industry, or if you perform work in accordance with government auditing standards, you should make sure that the candidates have experience in these areas.

You should identify the people assigned to the review team and inquire about their review experience. It is important to check the qualifications of the specific individuals rather than just relying on the firm's general reputation. You also need to determine whether the team captain has attended an approved reviewers' training course since 1985.

You may want to ask each firm for references from firms the size of your practice that they have reviewed. Call these other firms to discuss their experiences, and ask whether they received helpful insights from their reviewers and whether they considered the reviewers to be knowledgeable, efficient, and fair. Many firms consider an informal exchange of ideas to be a major benefit of a review. So inquire whether the candidates were helpful in sharing ideas from their own practices.

Fees

After you have determined that a firm is qualified, you should discuss the fee you will be charged. If the review is to be on a fixed-fee basis, determine if there are any contingencies. If it is to be on an hourly basis, obtain a budget reflecting the rates that will be charged.

To enable the reviewers to provide you with an accurate budget, you will need to give them sufficient information about your firm. This information includes copies of your prior peer or quality review report and letter of comments, and your response to the matters discussed in those documents; a copy of the report on your most recent inspection; information on the size and location of your offices; information on the number of accounting and auditing hours and the size and industries of the firm's five largest audit clients; and information regarding any SEC clients or Single Audit Act engagements.

EXHIBIT

AICPA Division for CPA Firms
Checklist for Selecting a Reviewing Firm

	Firm 1	Firm 2	Firm 3
1. Identify one or more firms that you might want to perform your review. (For assistance, you may wish to contact your state CPA society.)	____	____	____
2. Obtain general information or background concerning the firms in 1 above.	____	____	____
3. If possible, review the report and letter of comments on the most recent reviews of the firms being considered and their response to the matters discussed in those documents. Assess:			
a. Whether the firm received an unqualified report as required under the applicable standards.	____	____	____
b. The possible relationship of the matters contained in the letter of comments to your quality control system.	____	____	____
4. Identify those individuals who would serve on the review team and evaluate whether they possess the prerequisite qualifications.			
a. Determine whether the proposed review team has experience in the industries that comprise your practice.	____	____	____
b. Determine whether the individual designated as the review team captain:			
i) Is a partner.	____	____	____
ii) Has attended an approved reviewer's training course after 1985.	____	____	____
c. Determine whether the individuals designated as team members are either managers or partners active in accounting and auditing.	____	____	____
d. Determine whether someone on the proposed review team has the proper level of experience in SEC matters, if your firm has an SEC client.	____	____	____
5. Ask each firm for the names of firms your size that the individuals identified in 4 have reviewed.	____	____	____
6. Call the firms identified in 5 above and discuss whether:			
a. The firms received useful suggestions from the reviewers.	____	____	____
b. The firms considered the reviewers to be fair, knowledgeable, and efficient.	____	____	____
c. The firms would recommend the reviewers and were satisfied with their review.	____	____	____
7. Obtain a fee estimate.	____	____	____
8. Set the dates of the review.	____	____	____
9. Obtain the engagement letter.	____	____	____

A checklist of factors to be considered in selecting a firm to perform your review can be found in the exhibit on page 71. In addition, if you have any further questions about selecting a firm to perform your review, just call the AICPA quality review division: (212) 575-6650.

—*by* **Gerald H. Banwart, CPA,** *Heinold-Banwart, Ltd., 2400 North Main, East Peoria, Illinois 61611, and* **Dale E. Rafal, CPA,** *AICPA, New York*

Editor's note: Mr. Banwart is a member of the AICPA quality review executive committee and Ms. Rafal is vice president–quality review at the Institute.

CAN YOUR FIRM PASS QUALITY REVIEW?

December 1990

With thousands of firms expecting to have a peer or quality review in 1991, no doubt many practitioners are wondering how their firms will measure up. To have a really good idea, you must take a hard look at what your firm has done in the way of quality control in the past year and evaluate whether or not this complies with professional standards. The evaluation can easily be accomplished by your inspection program.

Inspection, the ninth element of quality control is, in essence, an in-house peer or quality review. It should determine if your quality control policies and procedures are appropriately comprehensive and suitably designed, adequately documented and communicated to professional personnel, and whether or not they are being complied with. These objectives parallel the quality review and peer review objectives.

Consequently, an effective inspection program will serve a dual purpose. First, it is a means of complying with quality control standards. Second, since it will provide you with "reasonable assurance that the procedures relating to the other elements of quality control are being effectively applied," it will tell you if you are indeed ready for the review. (Statement on Quality Control Standards no. 1 requires inspection policies and procedures to provide this level of assurance.)

A firm's inspection program will vary, depending on the firm's size, structure and nature of practice. Inspection for a sole proprietor may mean a self-review. Alternatively, a firm may decide to hire an independent quality control consultant or another firm to perform the inspection function. In either case, your inspection procedure should fit your firm and be adequate to test compliance with the rest of your quality control system.

An inspection program involves a review of documentation supporting your quality control policies and procedures, as well as selected engagement work papers, files and reports. Therefore, your own inspection procedures must include a review of those administrative files relating to the other "functional areas." Some of the compliance tests that may be used for these "functional areas" involve examining

- ☐ Personnel files for résumés or employment applications, transcripts, reference checks, and staff evaluations.
- ☐ The library.
- ☐ Independence confirmations and memorandums documenting the resolution of independence questions or problems.
- ☐ Assignment schedules.
- ☐ Staff manuals or other technical material prepared for the staff.
- ☐ Consultation memorandums or workpaper notations.
- ☐ Personnel manual or policies.
- ☐ CPE records.
- ☐ Training materials.
- ☐ Documentation on evaluation of acceptance and continuance of clients.

Naturally, you should also look at any other documentation required by your quality control policies and procedures. Remember that these inspection procedures need only test your quality control policies and procedures, and satisfy you that they are being complied with; you need not examine all records.

For example, if you have three audit partners, two managers, six seniors and ten staff accountants, you may decide that examining the personnel files of one partner, one manager, one senior and two staff people is adequate. Then, if you have enough information to evaluate compliance with your policies and procedures, you don't need to look at any more files.

The second and most important phase of your inspection program is the review of a representative sample of accounting and auditing engagements. Essentially, this is a five-step process:

1. Discuss the engagement with the partner or manager, and ask about any significant problems or unique aspects of the job that may affect the review.
2. Review the financial statements and report. This will give you a quick overview of the client and help identify areas that will be emphasized in the review and will indicate whether or not the quality control system ensures compliance with GAAP and GAAS.
3. Inspect the permanent files and other client administrative files.

4. Examine planning documentation, the audit or work program, the trial balance and any workpapers documenting control risk assessment, problem areas, and scope.
5. Review workpapers. This does not mean you should do a page-by-page analysis. Rather, you should concentrate only on those workpapers relating to significant areas.

Engagement reviews are really the key to determining how well your quality control policies and procedures are operating. For example, if the engagement reviews reveal that a particular policy or procedure is disregarded by most of your staff, then you may have a problem in the communication of your system. Or, this may be a sign that the policy or procedure is not really appropriate for your firm. You may also discover that, in each engagement reviewed, at least one or two required disclosures are missing. Here too, this may be an indication of inadequate review procedures. All of these items highlight the need for some follow-up action before you are ready for your peer or quality review.

After you have performed your inspection procedures, you should evaluate your findings. Keep in mind though that a few isolated instances of noncompliance are normal. Look for specific trends of noncompliance with your quality control policies and procedures, particularly for items that may signal noncompliance with professional standards.

The next step is to prepare a memorandum summarizing the results and follow-up action required to correct any problems. This memorandum should be discussed with all professional staff members. The presentation will serve as an additional means of communicating your quality control policies and procedures to staff as well as a tool to help improve performance and compliance. The memorandum and presentation should objectively discuss areas that need some work before the peer or quality review team comes in.

The inspection memorandum should not be the end of your inspection program. You should check to make sure that all weaknesses identified in the report are being corrected. Perhaps you should hold a postinspection meeting with your partners to objectively analyze all follow-up actions taken to date. Once you're satisfied that all problem areas have been cleared up and you have done a good job in your inspection, you will be in good shape for peer or quality review. ☑

—by **Margaret Loscalzo, CPA,** *Loscalzo Associates, 130 Monmouth Street, Red Bank, New Jersey 07701, tel. (201) 741-1600, FAX (201) 747-3763*

Editor's note: The above article is an updated version of Ms. Loscalzo's article that was published in the April 1981 issue of the Practicing CPA.

THE IMPORTANCE OF THE ADMINISTRATIVE REVIEW AS YOUR FIRM GROWS

July 1979

The accounting profession has entered a period of rapid change, and quality control peer review of certain documents, procedures and technical standards has become essential. (For firms in either section of the AICPA division for firms, compliance reviews are mandatory.)

A definite correlation exists between the quality of work performed for clients and the quality of internal administrative procedures. Unfortunately, too few CPAs are trained in administrative and management techniques, and many are simply too busy to run their practices effectively.

Growing firms have a need for a review of their administrative procedures because, in many instances, the partners try to do too many different things, which results in their spending a great deal of time solving problems. A review of a firm's administrative procedures can help the partners see where problems might arise and allow them to take appropriate action early.

What administrative procedures constitute

Developing an accounting practice involves setting goals and having a written philosophy underlying the firm's activities. It involves setting budgets, making projections and long- and short-range plans. A positive attitude is essential. You must start out on the right foot to be successful.

The essential ingredients in the administration of an accounting practice are:

- ☐ Financial administration and bookkeeping functions.
- ☐ Revenue controls.
- ☐ Billing and collection.
- ☐ Client engagements.
- ☐ Assignment processing and control.
- ☐ Review procedures.
- ☐ Report processing.
- ☐ Correspondence and filing procedures.
- ☐ Office facilities.
- ☐ Housekeeping functions and office management.
- ☐ Library organization.
- ☐ Insurance.
- ☐ Data on personnel, the partnership and management.

There are several types of administrative review available to a CPA firm. There are in-house reviews whereby one office reviews another (usually for a fee). These could be reviews of a segment of that firm, such as its partnership agreement. Then, there are reciprocal reviews (without a fee) between individual firms or groups of firms. (The Texas Society of CPAs fosters such groups.) Or, the review could be conducted by an independent consultant, or the firm could participate in the AICPA's local firm administrative review program.

Who should have an administrative review? The answer, according to the partners of many firms that have participated in the AICPA's review program, is all firms and especially any practice in which the partners think they are running it well. And, most advise having a review every three years.

How to handle the review

The program must be planned which means developing adequate procedures and a time budget. The first step is to check the engagement letter to determine that the scope of the review and the fee, if any, are the same as was agreed upon. Next, you should make sure that the reviewer is qualified.

Certain data are required, and these should be prepared beforehand (see exhibits) and, of course, documents will be requested. The list of documents in exhibit 2 is the minimal needed for a comprehensive review, although for selective reviews, such as that of a partnership agreement, all you would need is the actual partnership agreement itself.

The review engagement should include interviews with partners and with selected firm personnel. You will find that the staff is much more willing to talk frankly with outside interviewers than with partners.

In some instances, review procedures might include interviews with the firm's bankers and attorneys and with other professionals and business people in order to get a feel for the firm's image in the general business community.

When the review has been completed, a report should be developed identifying the organization's most critical problems and offering recommendations that might resolve them. Without these conclusions, the review is of little use.

Not all parts of an administrative review have to be conducted in the office of the firm being reviewed. Although interviews of principals and selected staff will have to take place in the office, interviews of outside people can be conducted on site. Initial data (see exhibit 1) can be sent to the office of the reviewer to give him time to familiarize himself with the information, and some of the documents can be forwarded as well. (Obviously, some documents cannot be taken from the office of the firm being reviewed.)

The administrative review can be a strong motivating force, because even though you may know that problems exist in your firm, you probably have done nothing about them. It usually takes the opinion of an outside, objective professional to get you to focus on improving the firm.

—by Leonard H. Brantley, CPA
Fort Worth, Texas

Exhibit 1—Initial Data Requirements

1. Name and office address(es) of organization.
2. A *brief* description of practice on predominance of types of clients served and on predominance of types of services rendered.
3. A *brief* description of the fee structure used for auditing, accounting, management advisory and tax services, together with a brief outline of time-keeping and time-budget system records utilized.
4. A *brief* description of the internal organization of your firm for professional work including lines of authority, audit review and use of hourly job budgets.
5. A *summary* of continuing education activities of principals and staff: graduate accounting seminars, institutes, AICPA professional development courses attended or taught. Include a description of any firm personnel training activities which are organized in regularly conducted classes.
6. A *brief* biographical sketch of all principals, giving education, all work experience, any work specialty and membership in professional organizations.
7. A *brief* biographical sketch of all professional personnel associated with the firm.
8. Do you carry malpractice insurance? If so, how much?
9. List the current technical subscriptions of your firm.
10. A *brief* summary of the contents of your library.
11. Does the organization have the *Management of an Accounting Practice Handbook?*
12. Furnish the following information about your practice area(s):
    a. Principal businesses or industries.
    b. Population, geographical description and location plus any unusual facets.

c. Number, type and size of other practitioners.
d. State society and local chapter professional activities.

13. Administrative review checklist completed by the managing partner or a principal.

Exhibit 2—Documents Requested

1. Partnership agreement.
2. Staff manual.
3. Written firm philosophy, policies and procedures.
4. Organization chart.
5. Long-range plan.
6. Financial statements, projections and budgets.
7. Production reports.
8. Newsletters and other mailers to clients.
9. Minutes and agendas of partners' meetings and staff meetings.
10. Books of original entry.
11. Work in process records.
12. Samples of invoices to clients, statements to clients, accounts receivable ledgers and accounts receivable schedules.
13. New client report, new assignment advice and client master record.
14. Checklist for timely completion of assigned work.
15. Checklists for tax planning and problems.
16. Recruiting brochure.
17. Personnel files.
18. Technical manuals.
19. Sample client report.
20. *Forms used for*
    a. Scheduling and assignments.
    b. Work processing (routing sheet).
    c. Business development (contact sheet, follow-up, etc.).
    d. Instructions to client.
    e. Time budgets.
    f. Billing—time and expense reports.
    g. Standard workpaper index.
    h. Engagement reviews.
    i. Employment applications.
    j. Employee evaluations.
21. Quality control system:
    a. Quality control document or
    b. Summary statement of the firm's quality control system with references to supporting information contained in manuals, memorandums or other technical literature of the firm.

Exhibit 3—Interview with Principals

Name ____________________

Position or title ____________________

Age ________ Specialty ____________________

Time with the firm ____________________

1. What should the long-range goals be for the firm? How large in five years? What kind of clients?
2. What are your long-range goals? Where do you fit into the firm's plans for the future?
3. What part do you perform in practice development?
4. In what organizations are you active?
5. Have you ever written an article or given a speech?
6. How many bankers and attorneys do you know personally?
7. In what areas does the firm specialize?
8. How useful are your partners' meetings?
9. Do you receive adequate financial information about the firm?
10. Are you satisfied with the firm's present billing rates and billing methods?
11. How are clients reviewed to determine whether or not the firm shall continue service or accept a new client?
12. When do you discuss fees with clients?
13. How are engagement letters controlled?
14. How is staff assigned?
15. How does the firm obtain cooperation of client's personnel in completion of engagements?
16. Do you have adequate professional liability insurance?
17. Are you satisfied with the partnership agreement?
18. What do you think are the weak points of the firm?
19. What do you think are the strong points of the firm?
20. Have you attained the quality of life you desire?

Exhibit 4—Interview with Selected Personnel
(At least one from each department)

Name_________________Position_____________

Age_______CPA?_______Education_____________

Time with firm_____________________________

Background and experience___________________

1. Are you aware of all services offered by the firm?
2. Have you ever been called upon to meet with a client for whom you do not regularly handle assignments?*
3. Have you ever participated in practice development?*
4. Does the firm encourage you to be active in organizations?
5. Have you ever written an article or given a speech?*
6. How many bankers or attorneys do you know personally?*
7. In what areas does the firm specialize?
8. Do you receive sufficient information regarding your assignments?
9. Do you ever receive assignments that are too difficult (or too easy) based on your knowledge and experience?
10. Are you provided a time budget on each assignment?
11. What procedures would you follow if an assignment you are handling is running over the allotted time?
12. Do you do most of your work at the client's office or your office?*
13. Who is your immediate supervisor?
14. Who is the managing partner of the firm?
15. Why did you come to work for this firm?
16. Do you receive adequate training?
17. How big would you like to see the firm become, and what role would you like to play in it?

*Exclude for administrative personnel.

ADMINISTRATIVE REVIEWS—A STEP TOWARD PRACTICE IMPROVEMENT

December 1986

Administration is a vital function in every accounting firm, and many find that an administrative review can be most helpful in identifying and dealing with achievement-oriented issues. Typical areas examined during an administrative review include the mechanical functions of the practice, such as billing procedures, report processing, staff evaluation policies, and the library.

A large portion of a review team's efforts is inevitably directed to the less tangible areas of firm administration, however. At this point, the term administrative review becomes a misnomer. In reality, it is a management review.

I have been a member of several administrative review teams, and it is my observation that CPA firms deteriorate from within, not from outside competition. I have not visited a firm where lack of business has been the root of any problem. In most instances, lack of business results from not seizing opportunities.

An accounting firm may face challenges when the senior partner's retirement is imminent, or when new partners are admitted. There is no absolute way to deal with either issue, although they can be handled in an orderly manner that benefits all concerned. Most of the firms I reviewed could be classified as mature—that is, the issue was retirement, not the admission of new owners. The following are two typical experiences.

The senior partners' ball and chain
The firm has seven partners—three in the 56-to-62 age group, one age 44 and the other three under 36. The three older partners founded and own 60 percent of the firm, but they have not developed replacements for themselves. They lack confidence in the younger partners' ability to "pay them out of future profits."

The younger partners also have doubts about the continuity of the practice if it has to make large payments to the senior partners. On the other hand, the younger ones don't think the senior partners are needed—they make too much money and don't work hard enough. To complicate the matter further, the partnership agreement does not have a legally sound non-compete clause.

In such situations, I believe one of three things will generally happen: **(1)** if the 44-year-old partner is a strong leader, a younger partner may leave, but the firm will hold together and the senior partners will receive something; **(2)** the senior partners, sensing their tenuous position, will sell the firm to fund their retirements; **(3)** some of the younger partners will leave, taking as many of the clients as they can, and start a new firm.

The younger partners may be able to buy out the senior partners from current earnings, but this could easily cause cash-flow problems. Usually, the younger partners are at a point in their lives where their personal needs are the highest (children in college, new houses, etc.). The added burden of funding withdrawing partners' retirements may not be practical. This may force a sale or a merger with a larger firm.

Another alternative is to negotiate a retirement arrangement for the withdrawing partners in which payment is a percentage of the firm's future earnings. Although this might work, it is certainly not a businesslike approach to the problem because it does not offer the security the retiring partners desire.

A better alternative is to plan the senior partners' retirements as far in advance as possible. The firm should set aside and invest funds to be available when needed. The senior partners should not share in the earnings from these funds in the interim or withdraw them.

There are several advantages to this suggestion, the first and foremost being a head start to buying out the senior partners. Also, the senior partners are assured of an orderly retirement, and the younger ones of stability for themselves and the firm.

Planning for senior partners' retirements is the best approach.

The out-to-lunch patriarch

The above description is not necessarily that of the senior or managing partner; it could apply to any partner who has simply lost interest in the practice, does not produce, and seems more concerned with being paid and not rocking the boat. The other partners realize they have a problem partner, but are unwilling to deal with the situation. This is likely to result in a crisis and in emotions that do not permit logical solutions. Often, there are no expulsion or early retirement clauses in the partnership or shareholder agreement. And even with a model clause present, there are still serious challenges.

Either the out-to-lunch patriarch must be stimulated to become productive, or must find interests outside the firm. Usually, by the time the problem is dealt with, the first alternative is not practical and the other partners are postured to expel the unproductive one.

At one firm, while conducting an administrative review, I was asked to dismiss the managing partner who had this profile. This was not a pleasant or easy task for me, but it was necessary for the long-term well-being of the firm. Fortunately, the shareholders agreement had a buyout provision that was reasonably workable, but the problem would have been easier to resolve had it been addressed years earlier.

The staff needs love, too

Most management problems in accounting firms are people problems. The natural reaction of most partners to such problems is to immerse themselves in professional and technical tasks and hope the problems disappear. Unfortunately, the problems usually fester, and loyal staff lose confidence in and respect for both the firm and partners.

This is a key point. Partners must learn how to manage people and deal with people problems. It's part of the job. Based on my experiences conducting administrative reviews, the most successful firms are those that consider staff the most valuable firm asset, and treat their people accordingly. Partners must be people managers if the firm is to reach its optimum success. And staff must be an integral part of the organization team and have meaningful input into what the firm is planning and doing.

A method our firm has used to accomplish this objective is an annual staff retreat. These are typically of two days' duration with mornings and evenings devoted to work and the afternoons to leisure activities. We have found that holding the retreat at a remote location with a spartan environment works best for us.

We review the prior year's plans, goals and results, and set new goals for the coming year. The firm's long-term plan is also reviewed and discussed, and younger staff members give presentations on the topics that they were preassigned to research.

We engage an outside speaker to give a nontechnical presentation on a "people" topic, such as motivation, personnel, management, and trends. Most accountants have little formal education in these areas, although such skills are vital to a firm's success.

Another way to encourage staff participation is through the use of attitude feedback questionnaires. The questions typically range from those dealing with firm working conditions to the adequacy of its management. Everyone should be required to complete this form, and the results should be summarized by partner, principal/manager, professional staff, and administrative staff.

Reviewed firms have found this to be a particularly effective way to evaluate staff and partner perceptions of the firm. Sometimes, what is revealed is not pleasant, such as previously unspoken partner differences or problems relating to the retention of key staff. This early and frank assessment is helpful, however, and an important step toward practice improvement.

Partner communication

Substantive issues must be dealt with and all partners informed about what is going on regarding clients and staff, etc. The time for such discussion is at the partner evaluation sessions.

Getting partners to discuss sensitive issues is essential.

Communication problems are usually identified during an administrative review because each partner and selected staff is interviewed by the review team, which can often facilitate discussion between partners on sensitive issues.

Model partnership agreements, planning and funding for retirements, staff counseling, and motivation are necessities for today's accounting firms. And many will find that an outside administrative review team can identify and address their weaknesses and problems in these areas while they are in the embryo stage.

In the final analysis, I am confident that any local firm will find an administrative review to be one of the most valuable experiences it can receive for itself and its clients. ☑

—by Philip D. Neville, CPA
Greeley, Colorado

HAWAIIAN PUNCH

November 1987

When the staff of the AICPA industry and practice management division called to invite us to go to Honolulu to participate in a MAP conference, it did not take much persuasion. With one of us from Bethesda, Maryland, and the other from Marshfield, Wisconsin, the prospect of Hawaii in November was too tempting to pass up.

First, some background. The local practitioners committee of the Hawaii Society of CPAs, in developing a program for its MAP conference, decided that the Local Firm Management Consultation Program of the AICPA would provide a good basis for acquainting participants with current practice management information from the mainland. The idea was to have a two-member team of CPAs who had performed firm management reviews for the AICPA give presentations at the conference.

To give the presenters some insight into the practice of public accounting in Hawaii and to entice practitioners to attend the conference, the committee decided to arrange for the presenters to conduct three firm management reviews in the two days prior to the conference. These reviews would necessarily be scaled down versions of the customary two-day AICPA program (see box at right), but the purposes would still be served. The presenters would gain some understanding of Hawaiian CPA firms, then gear the program toward the types of firms they had reviewed.

The creative talents of the committee surfaced in the method of selecting the firms to be reviewed. Notices telling members about the conference contained a message that the firms to receive a free mini-review would be randomly selected from those conference registrants who indicated a willingness to participate. And so it was.

With the structure in place, the next step was to ask the AICPA's assistance in providing two experienced reviewers to conduct the program. That's when we were contacted.

We had not met before and were both anxious to get acquainted and see what kind of chemistry would develop. We and our wives (you didn't think they would let us go alone, did you?) were met at the airport with traditional lei greetings. But because we arrived in Honolulu at different times on the Tuesday afternoon and had conflicting plans that evening, we did not meet until Wednesday morning.

We did find much in common, including having the same first name. One of us chooses to be called by his middle name, however, and that simplified things considerably during the next few days.

Before leaving the mainland, we had agreed by telephone that we would work as a team on the first mini-review, then each separately review one of the other two selected firms. The names of the firms to be reviewed were kept confidential so that they could in no way be identified in any remarks we might make at the conference.

These mini-reviews were helpful in providing us with an insight into the operation of local practices. Each firm was forthcoming and most receptive to the process. This was the base on which our Friday MAP conference program was built.

We held a brief planning session on Thursday evening to coordinate our approaches and organize the program for the next day. It had already been agreed that we would use as our outline the topics covered in the AICPA Local Firm Management Consultation Program questionnaire which the registrants had been requested to complete prior to attending the conference. This would target our comments and also provide information about the AICPA program. We divided the topics between us, and that ended the planning meeting. We had provided some handout material for inclusion in the conference booklet, but had not prepared remarks at all. The entire

AICPA Local Firm Management Consultation Program

This AICPA program is a confidential two-day review of the participating firm by a team of two practitioners who are closely involved in the management of their own firms. A consultation is usually scheduled six to ten weeks after an engagement letter is signed. The firm participates in the selection of a team, and attempts are made to meet requests for consultants with expertise in particular areas.

The review is based on the comprehensive questionnaire in chapter 502 of the *MAP Handbook*. At least two weeks before the consultation takes place, the firm completes the questionnaire and sends it to the consultants who will use the information on the firm's operation and organization as a starting point for their on-site review of firm procedures.

The checklist covers such areas as

- ☐ Practice development.
- ☐ Financial administration.
- ☐ Partnership agreements.
- ☐ Staff scheduling.
- ☐ Billing and collection procedures.
- ☐ Review controls.
- ☐ Office facilities.
- ☐ Filing systems.
- ☐ Personnel recruiting.
- ☐ Staff training.

The consultation can include confidential interviews with partners and staff, and an examination of various documents, records, agreements, and contracts. These interviews can often identify communication problems and facilitate discussion of sensitive issues.

Many partners find that the review helps them to formalize goals and objectives, and to confront problems that were not being addressed. Others think that there are benefits to be derived just getting ready for the reviewers.

Who should have a review?
Some partners think that all firms could gain from the experience, especially practices where there is concern as to whether the partner retirement plan will really work, or if the firm has difficulty retaining outstanding members of the staff. In his December 1986 article in the *Practicing CPA*, Philip D. Neville, a Greeley, Colorado, CPA, says that model partnership agreements, planning and funding for retirement, and staff counseling and motivation are necessities in today's accounting firms. Many firms, he believes, will find that an outside administrative review team can identify and address weaknesses and problems while they are in the embryo stage.

The AICPA consultation program concludes with a confidential conference between the consultants and the involved partners. This begins with a summary of the consultants' findings and includes a discussion of the important points brought forth by the questionnaire. The focus is on helping the firm develop a one- or two-year schedule for improving its administrative procedures and, in addition to helpful suggestions, might include offers to exchange forms, checklists, and manuals.

The cost is $1,700, which covers all direct expenses of the consultants. For further information, contact the AICPA industry and practice management division: (212) 575-3826. ☑

eight-hour conference would be spontaneous and unrehearsed.

Public accounting in Hawaii is practiced, for the most part, in relatively small units. Although national firms are present, the majority of CPAs operate as sole practitioners or as firms of two or three partners. A "large" firm, of which there are few, has, perhaps, twenty-five to thirty-five people. Another typical arrangement is for two sole practitioners to share quarters and some staff, yet operate strictly as individual practice units. It was to these CPAs that our program was to be addressed, and structured in a manner that would provide the best possible interchange of ideas that would be helpful in operating their practices.

Another lei greeting on Friday, and the program was underway. It didn't take long to find out that the day would go well. Although we each spoke on the topics assigned, calling on personal experience and bringing in comments from the other, we kept the program open to questions from participants at all times. This allowed for a good interchange of thoughts and ideas, and we were pleased to find a responsive audience that participated fully from beginning to end. Although question cards had been provided, most people ignored these and preferred to state their questions orally.

The program provided a full day of discussion on a wide range of practice management issues. There were differences of opinion, from time to time, between the speakers and the attendees, and between the speakers themselves, all of which added to the value of the program.

As an aside, we should comment on the reactions of our wives to our Hawaii visit. Teresa (Ed's wife) was observed looking through realtors' advertisements, mumbling words like "retirement" and "warm," while Sandi (Burn's wife) was overheard telling him, "If we are ever going to have a fight, now is the time!"

Both of us have come away from past local firm practice management programs with the feeling that we gained even more than we gave. The Hawaii society's MAP conference and everything that went with it was no exception. We believe that the objectives were achieved, and would recommend the idea to other state societies, particularly those with relatively small memberships. ☑

—by E. Burns McLindon, CPA
Bethesda, Maryland, and
Edmond L. Smith, CPA
Marshfield, Wisconsin

Section 6

FEES AND BILLING

EXPLAINING PROFESSIONAL FEES

November 1987

If clients are fully advised of the scope of engagements and the manner in which fees are determined, disputes over fees should be minimized. Recently, we prepared the following memorandum to explain our fee structure to new clients and to aid in resolving any questions that might arise.

FEE STRUCTURE

From time to time, we get inquiries concerning our method of charging fees. This is understandable since each CPA firm handles fees a little differently and some new clients may not have used a CPA before. This letter is our tool for communicating our fee structure to clients and other interested parties.

BASICS

Each staff member maintains accurate time records, and clients are billed based on actual time spent on their behalf. Since we sell no products and accept no contingent fees, our time and expertise is our only source of revenue.

HOURLY RATES

A standard hourly rate is set for each staff member based on the criteria of experience and ability. If no extenuating circumstances exist, clients are billed using standard hourly rates multiplied by the actual hours worked. It is not uncommon to adjust the fees so determined to recognize:

- ☐ excessive time spent in an unfamiliar area.
- ☐ excessive hourly rates due to unavailability of less experienced staff to perform routine accounting jobs.

Hourly rates vary substantially among staff members—currently from a low of $20 to a high of $75. Accordingly, it makes sense to use less experienced staff members to perform routine accounting procedures to achieve the lowest hourly rate.

TELEPHONE CALLS

Telephone calls are treated the same way as any other time spent on a client's behalf. If matters of substance are discussed, the time is charged and billed to the client. Personal calls of a non-business nature are obviously not charged to clients.

Due to the extensive amount of consulting work done by our firm, conducting business by telephone consumes a substantial amount of our time. For some senior staff members, as much as 25 percent of their time is devoted to telephone consults. The telephone can be an effective, time-saving device, and we make maximum use of it.

OUT-OF-POCKET EXPENSES

Basic overhead costs are included in the hourly rates. Anything spent specifically on behalf of clients is charged to them. Travel, postage, copies, long distance telephone calls, etc., are included in this category.

We believe that effective client relations are essential if a fair fee is to be realized, and that the time to take action is when the engagement is arranged. We find that sending clients a memorandum, such as the above, is a good way to acquaint them with the rationale behind the setting of professional fees. ☑

—by Joe D. Jones, CPA
Jackson, Mississippi

HOW TO VALUE YOUR FIRM'S SERVICES

August 1983

When clients buy a CPA firm's services, they are not just buying accountants' time, they are also buying their accumulated knowledge and experiences. In effect, clients don't buy audits or tax work; they buy order or credibility or freedom from anxiety. If a CPA firm is dependable and can deliver on time, clients are often willing to pay a premium for its services.

At the AICPA small firm conference last year, J. Wayne Winfrey, a Dallas, Texas practitioner, explained how in the mid-1970s, he and his partners came to the conclusion that as a small firm of 12 people, they could not be all things to all clients and, instead, should concentrate on specific areas. When they looked at their clients' industry codes, they found that many of them were in the real estate, construction, oil and gas and financial industries, or else they were substantial investors or professionals. As a result, they decided to limit their practice to these groups and to direct their marketing efforts toward them. The partners resolved to stress value in their services to clients which would yield a high fee structure. They also aim for 15 percent growth in billable hours each year and to achieve these goals need staff accountants who can earn their way from their first day with the firm. Consequently, the firm doesn't hire beginning accountants, but uses the AICPA Accounting Testing Program for preliminary evaluations of trained accountants.

Mr. Winfrey said that the firm believes that the old rule-of-thumb measurements for determining fees have fallen by the wayside during the last few years—that figures such as two percent of monthly salary per hour or multipliers such as three and one half times hourly salary are no longer valid. He thinks partners should net 45-50 percent of gross billings.

How do I bill thee? (Let me count the ways)*

Annual salary ($)	÷ (Hours)	Multiplier	Other	Hourly rate ($)	Potential annual billing† ($)	Contribution to firm's gross profit
18,000	2,080	2		17.31	29,423	11,423
18,000	2,080	2½		21.64	36,779	18,779
18,000	2,080	3		25.96	44,135	26,135
18,000	2,080	3½		30.29	51,490	33,490
18,000	1,700	2		21.18	36,000	18,000
18,000	1,700	2½		26.47	45,000	27,000
18,000	1,700	3		31.76	54,000	36,000
18,000	1,700	3½		37.06	63,000	45,000
18,000			‡	30.00	51,000	33,000
18,000			§	27.00	45,900	27,900
18,000			‖	22.50	38,250	20,250

*Note: The above chart is hypothetical and should be viewed for illustrative purposes only.
† Assumes 1,700 billable hours per year
‡ 2% of monthly salary, per hour
§ .0015 of annual salary, per hour
‖ An hourly rate of 1% of annual salary

The following ideas for valuing a firm's services are based on Mr. Winfrey's presentation.

There are a number of cost items that should be considered when determining fees. Start with the overhead—CPE for example, the costs of which can be very high. Other expensive items are staff salaries and liability insurance. Then, of course, you must earn an adequate return on capital and, because retirement is such a big threat to local firms, you must consider the cost of funding pensions.

Start new staff members at a break-even rate to avoid having write-downs. Then, raise the rate every three months and get them up to retail after they have been with the firm for a year. Price paraprofessionals internally at the same multiple as professionals. Paraprofessionals work hard, don't spend time theorizing and can often play a major role in the firm. Don't charge directly for clerical services because of the tendency for every miniscule job to be recorded and billed to the client. Instead, put a one to two percent rate surcharge on the professionals.

Is some work worth more than other work? Generally speaking, the answer is yes. However, a lot depends on the type of practice you have and the market area in which you are situated. Multiple rates seem to have fallen out of favor. However, if you do have multiple rates, don't tell clients what your minimum fee is or they will all want it. Many innovative things can be done regarding product pricing, though. For example, accountants have been doing financial planning for years but have not marketed this service as professional financial planners have done.

Setting fees for proprietors, partners, shareholders and officers is difficult. You can start by setting the fees the same way you set staff fees and see how that works out. This means keeping in mind all the other factors in addition to your allocated "salary." Most partners set their fees too low considering the experience they are bringing to the engagement.

While there are difficulties, there are also opportunities in fee setting. For example, don't overlook the giveaway syndrome. Accountants tend to give answers to complicated questions at lunch, on the phone or at other inappropriate times. Instead, say something like, "Yes, it is an interesting question. Let me research it for you." Then, put the answer in writing and to capitalize on your time and experience, send a bill for it.

It is important to let people know how you want to be treated at the first meeting. Tell them what your firm charges for your time (give them the average fee for work) and ask if it is a problem. If the answer is no, explain that you bill twice a month and expect to be paid by return mail. If the client is late paying, get your bookkeeper to call and ask if there is a problem.

As a partner, don't do work someone else should be doing. Teach staff how to do as much as possible and put a high rate on all partners so that they can't afford to do these jobs. Also, if you have a pet client, let one of your partners evaluate what the engagement is worth and do the billing.

You should have a billing control system to avoid different clients being billed different rates for the same work. Have every bill checked by the managing partner before it goes out; then you are more likely to realize standard. And keep in mind that nowhere is it written that an hour's work has a maximum dollar value.

There is an art to drafting and collecting a bill. If clients know what the rate is before you start the engagement and you have verified that this presents no problem to them, collecting the bill is going to be much easier. Clients must know everything that was done on the engagement and why, and you must make sure that change orders are communicated. Do a postmortem on previous engagements and send the clients a management letter pointing out that they have not taken advantage of this or that. This is a good way to expand services to present clients and is an area where a word processor can be really useful.

Finally, get staff involved in the billing process—they know the details about every engagement. Make sure you cover all expenses such as long-distance calls, and if you use a tax service, make a profit on the deal. Don't just swap dollars or be a banker for clients.

While locale is an important factor when setting fees, it is not an exclusive consideration. To obtain a high fee structure, first develop expertise in a given service area and then build your image as a specialist by providing quality and timely service. While you might suffer from competition with lower-priced firms in the short term, in the long run you are bound to benefit.

CLIENTS CAN HELP MINIMIZE INCREASES IN AUDIT FEES

January 1981

What with inflation and one thing and another, audit fees are increasing. However, increases can be minimized through client cooperation to reduce the time your staff spends on an audit.

Here are a few ideas based on suggestions Rubin, Brown, Gornstein & Co. of St. Louis, Missouri, gave its clients in a recent issue of its newsletter. For example, audit time can be reduced if clients

- ☐ Provide your staff with adequate working space and some degree of privacy. Efficiency will increase.
- ☐ Review the prior year's audit with you. Time can often be saved through critical planning.
- ☐ Let you know before entering into unusual or significant transactions, such as acquisitions or sales of major assets. Explain to clients that accounting matters are best resolved prior to the audit date.
- ☐ Consult you in planning physical inventory-taking. You can help them develop needed forms and procedures and tell them what they have to do and what your function is.
- ☐ Reconcile intercompany accounts.
- ☐ Know which schedules will be needed and prepare them for you. They can then correct any errors and mispostings and make certain that all schedules agree with the books of account.
- ☐ Set up procedures to provide your staff with needed invoices, contracts and other documents.
- ☐ Talk to you about using their data processing systems in the preparation of certain analyses.
- ☐ Tell you if any phase of the preparation, such as inventory counts, won't be ready at the agreed time. Unnecessary surprises increase the time your staff must spend on an engagement.
- ☐ Explain to their staff people that while an audit may seem to be a disruption, it is both necessary and costly. The meter keeps running when your staff has to wait for data.

Relations are helped if clients' staff people realize that CPAs aren't detectives. Ask clients to explain to their people that when you ask them questions it is not a reflection on their competence or integrity. Tell clients, if they can do the things mentioned, they can help keep audit fee increases to a minimum.

PROFESSIONAL FEES—A PRODUCT OF GOOD TIMEKEEPING

October 1979

For most professional firms, time spent to render a service is a key element in the determination of fees. While ascertainment of the dollar rate is based on a number of factors, some of which are judgmental, time spent can be calculated precisely. Therefore, since time is the basic and most objectively measurable element of the cost of sales of a professional practice, the knowledge of how staff members spend their workday is vital.

There are still some professional firms that do not keep complete time records on the premise that they know how long it takes to service clients. However, when one keeps exact track of one's workday, the results are often surprising. A telephone call here, a research question there, a conference with an attorney all add up. Before long the two-day-a-month client actually accounts for two and one-half days.

Maintaining precise time records serves several functions. The records provide objective data for billing, aid in selling the fee, help control job costs and furnish a historical base for future proposals.

A rough estimate of time spent is not likely to convince a client that his fee should be increased. However, if the practitioner can provide statistical proof that the job ran to X additional hours per year, the client may be more readily persuaded.

If clients are kept informed of the cost of accounting services from the beginning of the association, they will adjust to paying higher fees as their needs for professional services grow. Time records that are summarized by client, personnel and task, and which are analyzed regularly, indicate what services are being performed and can be a helpful tool in client relations.

A practitioner who becomes aware of an inadequate fee at the outset of an engagement can propose methods for either reducing the total time required to do the job or for shifting certain aspects of the work to a staff member with a lower billing rate. The key value in maintaining and analyzing time records is the timely availability of significant data upon which action can be taken.

The foundation of any timekeeping system, regardless of its level of sophistication, is the individual time report. This report should account for the entire workday including overtime of each individual. At the very least, it will provide data for determining the cost of clients' work as well as a basis for paying employees. In its more refined versions, particularly when the data are used as input for electronic data processing (EDP) systems, the information can be analyzed in many different ways for varied uses.

Computerized time reporting systems are broadly available today through service bureaus, ter-

Exhibit 1—Detailed Billing Report 8-31-79 Page 250

Office Bec. Project Number 82500 Client name Pu-c-p

Employee Number	Name	Task code	Current month Hours	Current month Amount	Beginning to date Hours	Beginning to date Amount
035	Wyson N.	00	.00	.00	1.50	21.06
061	Krandenburg H.	08	.00	.00	11.50	93.03
062	Kroches P.	00	.00	.00	3.00	39.30
074	Surtz J.	00	26.00	310.18	124.50	1,485.28
074	Surtz J.	01	3.00	35.79	13.00	155.09
074	Surtz J.	04	2.00	23.86	9.00	107.37
074	Surtz J.	09	3.50	41.75	6.50	77.54
080	Bageser D.	00	.00	.00	7.00	79.94
080	Bageser D.	07	.00	.00	6.00	68.52
080	Bageser D.	33	1.00	11.42	1.00	11.42
217	Traverman L.	01	26.00	181.22	26.00	181.22
217	Traverman L.	02	44.50	310.16	103.00	717.90
217	Traverman L.	04	.00	.00	23.50	163.79
Nonpartners' total time			106.00	914.38	335.50	3,201.46
093	Henshaw A.	20	2.00	43.26	2.00	43.26
Partners' total time			2.00	43.26	2.00	43.26
Administration		00	26.00	310.18	136.00	1,625.58
Special research		01	29.00	217.01	39.00	336.31
Project program		02	44.50	310.16	103.00	717.90
Survey		04	2.00	23.86	32.50	271.16
Cost and budget		07	.00	.00	6.00	68.52
Promotion		08	.00	.00	11.50	93.03
Project travel		09	3.50	41.75	6.50	77.54
Plans		33	1.00	11.42	1.00	11.42
Nonpartners' total time by type of task			106.00	914.38	335.50	3,201.46
Administration		20	2.00	43.26	2.00	43.26
Partners' total time by type of task			2.00	43.26	2.00	43.26

Exhibit 2—Employee Time Analysis by Type of Work 8-31-79 Page 61

Employee Number	Employee Name	Type of work Number	Type of work Description	Current hours	Year to date hours
074	Surtz J.	00	Administration	26.00	124.50
074	Surtz J.	01	Special research	3.00	13.00
074	Surtz J.	04	Survey	2.00	9.00
074	Surtz J.	09	Project travel	3.50	6.50

(Because of space limitations, data on holidays, sick pay, business promotions, etc., have been deleted from this printout.)

Employee totals ___ ___

minals and minicomputers, and EDP can be feasible and worthwhile to smaller local firms (six or more staff members) if the information generated is fully utilized.

The benefits of converting a time reporting system to EDP are not only in the labor saved but also in the abundance of additional data generated. By utilizing a computer, hours can be multiplied by applicable rates and can immediately show dollar amounts. A major cost of an EDP system is the manpower and time required to feed information into the computer. Once the input is completed and the system allows the information to be used in many different ways, there is relatively little additional cost.

Exhibit 1 is a sample detailed billing report of a professional firm (in this case an architectural firm) that lists every task performed by all staff members for a particular client. This type of client report can be accumulated based on the 12-month year of the CPA (or any other professional) firm, or they can be retained on an ongoing basis until a long-term project is completed. The reports provide more than billing information; they also supply a history of what the job entails in terms of tasks, personnel and skill requirements. This allows one to make comparisons—to say that a particular phase of the job is similar to that done for Client A two years ago, etc. Having this history available enables one to make more accurate proposals, which can mean both getting the job and making a profit on it.

The dollar amount column can be based on a billable rate or a cost rate per employee. While the former eliminates a manual calculation, the latter is useful if the firm has various billable multiples on different clients. This situation may result from different calibers of work required, or from the fact that one is working for a governmental authority and only certain billable rates are acceptable.

The second report from the EDP professional time system (see exhibit 2) is the employee time analysis by type of work. In selling one's services, it is often necessary to be able to determine direct personnel expenses. These include not only payroll taxes and other additional expenditures for an employee but the portion of the employee's salary that was utilized for holidays, sick pay, business promotion, etc. These factors are readily determined from this report and enable the firm's administrator to ascertain the nonchargeable portion of staff time as well as to evaluate individual staff members.

Given that a firm wishes to use a computer for its timekeeping, the following basic information will be required:

- ☐ Range of clients' account numbers. (Numbers must be assigned to all accounts.)
- ☐ Range of staff members' numbers and hourly billing or cost rates.
- ☐ Partners' names and numbers, if partner responsibility is to be added to billing reports.
- ☐ Classification of chargeable time with numbers assigned to each classification.
- ☐ Classification of nonchargeable time with numbers assigned to each classification.

Timeliness is the heart of good billing and is facilitated by a good timekeeping system. Prompt-paying clients are trained, not born. Bills should be sent out promptly and on approximately the same day each month to convey the impression that professional fees, like any other charge, should be handled in a businesslike manner. Fees should not be allowed to accumulate before being billed because the larger debt can become a burden to a client. Occasionally, it may be necessary to go along with a client for awhile until the client becomes established. Even so, increasing the debt in small doses makes the amount more palatable.

The use of a good professional time reporting system can aid in fee collection and can increase profitability. Add to this a good engagement letter or a contract that has been thoroughly discussed before starting the engagement, immediate follow-up of tardy payment to determine if any modification is required in the method of providing the service or in the total services rendered, and the fees should flow through the firm in as orderly a manner as their computation flowed through the computer.

—by Jeanne Zweig, CPA
Philadelphia

THE ADVANTAGES OF A GOOD TIME RECORDING SYSTEM

November 1977

In addition to determining how much staff time was actually spent on an engagement, a well thought out time recording system can provide much additional information to help increase the efficiency and profitability of a practice. Here are a few things to keep in mind when setting up a system, and some of the potential benefits:

- ☐ Make sure it provides a chronological record of all staff activities, including those that are not chargeable to a client.
- ☐ Have it coded for billing purposes, to show the different types of work performed, and the different categories of staff engaged on each assignment.

- ☐ The input of data should be arranged in such a way that permits its easy transfer to other records such as client files.
- ☐ It should simplify the study of how much of each staff member's time is chargeable to clients over a given period. This is done by deducting from the number of working hours available all non-chargeable time such as vacations, sick days, unassigned time, etc.

Even this short checklist makes it easier to:

- ☐ Plan work schedules and estimate time required for each assignment. Prevent undue time being spent on any one aspect of the job, and ensure that the work is completed on time.
- ☐ Use personnel more effectively and obtain maximum productive time.
- ☐ Evaluate each individual's performance for promotion, salary increases, etc., by permitting comparisons with an average for all staff.
- ☐ Reduce disputes with clients over fees by providing an instant record of services performed, and the time spent by staff on them.
- ☐ Determine if additional staff is required and how many more billable hours this should produce.
- ☐ Convert time into dollars. The coding system for the various billing rates will put a dollar value on the work performed and facilitate determination of a fair fee.

QUESTIONS FOR THE SPEAKER (FEES AND BILLING)

March 1990

One of the benefits of attending practice management and small firm conferences is being able to ask the speakers, panelists, and other participants about their solutions to specific practice problems. The questions usually cover a wide range of topics concerning firm management, partnership and personnel issues, and practice development ideas.

At various conferences, participants have asked about billing for computer time and whether anyone knows of a formula that can be used. Others questioned how to involve staff in the billing process, and at what stage in someone's career this should begin. We asked our editorial advisers for their thoughts on these questions.

David A. Werbelow, who practices in Pasadena, California, says that while the partner in charge should have the final word, staff should be involved in a bill's preparation. He suggests that a staff member with two or more years of experience could recommend the bill amount, and also write the appropriate detail narrative. He says Martin Werbelow & Co. does not have a formula for billing computer time.

Mesarvey, Russell & Co., a Springfield, Ohio, CPA firm, does not use a formula either, but, at the time the question was asked, billed $20 per hour for computer time. Ronald C. Russell, partner of the firm, believes that staff members should be involved in the billing process as early in their careers as possible. He thinks that staff members spending most of their time on a particular job should prepare the billing after comparison to the estimate for the job. The bill would then go to the partner in charge of that job and subsequently to a second partner for review.

Sidney F. Jarrow, an Elmhurst, Illinois, CPA, suggests computer time should be billed out at a rate per hour for the operator, taking into consideration hardware and software costs. Regarding who should prepare the bill—if the partner does not—he says, "Leave people on the job if they do it well and tend not to write down to the same degree partners do." He believes staff should prepare the bill and the partner review it, and that any level of staff can be involved in billing.

Richard A. Berenson, a New York City practitioner, says, "We have no formula for billing clients for computer time. At this point, we bill the time spent by the person operating the computer." Berenson, Berenson, Adler & Company uses computers for forecasting and special work, and Mr. Berenson, partner in the firm, says managers are involved in client billing and should maintain some responsibility for collection, too. ☑

SOME THOUGHTS ON BILLING

December 1977

Some practitioners think that billing should be the responsibility of one individual in a firm, others believe that many people should be involved. I endorse this latter thought.

The responsibility for initiating the bill should rest with the partner in charge of the job, but he should involve at least the top staff personnel who work on the engagement. There are several reasons for this:

- ☐ Staff members are the people most familiar with the difficulties encountered in the engagement.
- ☐ They know the complexities of the situation.
- ☐ They know the extent to which the client

prepared the working papers.

- ☐ They know whether the client had the necessary information ready and are aware of other factors that affected the time involved.
- ☐ Having the staff participate in the billing procedure makes them more aware of the fact that time is money.

However, I will agree with those who say that there must be centralized control. In the case of a small- or medium-sized firm, all bills should be reviewed by the managing partner. There are several reasons for this too:

- ☐ Only in this way can a firm approximate a uniform billing philosophy.
- ☐ It can prevent consistent under or over billing.
- ☐ It will reveal which partners have a large unbilled inventory, or slow paying receivables.
- ☐ Partners can be prodded into sending out bills.
- ☐ We check our clients' inventory turnover. Someone must do the same thing in an accounting firm.

—by William B. Nicol, Cleveland

A CLIENT-SERVICE MONITORING SYSTEM

October 1984

On January 1, 1982, our firm implemented a new client-service monitoring system to control all engagements. Our intention was that the system, which is integrated with our client billing procedure (see description later), should have the following objectives:

- ☐ Provide an inventory of all engagements currently outstanding.
- ☐ Provide man-hour requirements by service code and responsible person, to complete work currently outstanding.
- ☐ Monitor timely completion of client engagements.
- ☐ Monitor timely billing of completed engagements.

The client-service monitoring system revolves around data generated by the completion of a form we call a client service request (CSR; see exhibit I). Every client service for which time is charged necessitates completing one of these forms. The only exceptions are those jobs that require one hour or less to complete. In these cases, time is charged to a special CSR number and a memorandum placed in the appropriate client billing file for reference. Apart from these cases, all time is charged to a CSR number rather than to a service code as in the past. And we have modified our time sheets to reflect this.

Exhibit I

Client service request (CSR)

CLIENT NAME & DESCRIPTION (MAXIMUM 45 CHARACTERS INCLUDING SPACES)				CSR#
RESP 1 / RESP 2	SERVICE CODE	- - MM / DD / YY COMMITMENT DATE	- - MM / DD / YY DUE DATE	CLIENT#

- - MM / DD / YY Date Received	BY	DATE	LAST YR. BILLED $ / THIS YR BUDGET $	LAST YR ACTUAL / THIS YR BUDGET
	DELETED		DOLLARS	HOURS

DESCRIPTION: ______________________________

The following is an explanation of some of the information we enter on the CSR:

- ☐ *Client name and job description*—up to 45 characters can be used to describe a job.
- ☐ *Responsible person*—includes the initials of the manager or shareholder responsible for the timely completion of the engagement.
- ☐ *Service code*—a schedule of codes and the types of work to be charged to each is available.
- ☐ *Commitment date*—a six-digit number which is entered at MM/DD/YY; e.g., 01/10/84, is the targeted completion date.
- ☐ *Due date*—the date an engagement must be completed.
- ☐ *Data entry*—initialed and dated by the data-entry clerk at the time the information is entered into the computer.
- ☐ *Deleted*—initialed and dated by the data-entry clerk at the time the engagement is completed.

CSRs are prepared by the person responsible for each client service. When a CSR is completed, it is reviewed by the office manager for omissions and inaccuracies and is attached to another form we use. Known as "Instructions to report department" (see exhibit II), this form is part of the instructions for each engagement assigned to staff. This makes the CSR accessible to every staff member in the firm because a CSR number must be generated before our computer system will accept time. The back copy of the CSR is sent to the data processing department and after processing, the cards are placed numerically in a "jobs in progress" file.

As client engagements are completed and delivered, a job delivery ticket is prepared. Then each Friday, a data-entry clerk updates the due-date monitoring file from the data on these reports and on new CSRs. When each job is completed, the corresponding CSR is pulled from the "jobs in progress" file and placed in the appropriate billing folder to serve as an aid in the billing process.

With the file updated, a weekly report of all engagements in process is then generated and sorted

Exhibit II

Instructions to report department
(Other than tax returns)

Client name ______________________ Shareholder ______________

Client number ______________________ Manager ______________

CSR number ______________________ Other ______________

Date wanted ____________ Committed ____________ Absolute deadline ______________

Mail to: ______________________

Deliver to: ______________________

Number of Copies

	Management letter	Report (A)
Client		
Office copy		
Shareholder		
Manager		
TOTAL		

(A) Report to be bound Yes ____ No ____

Description, or, if applicable, EXACT wording for cover:

Line #22 — Heading (name)

Line #23 —

Line #35 — Report description

Line #37 — Period and date

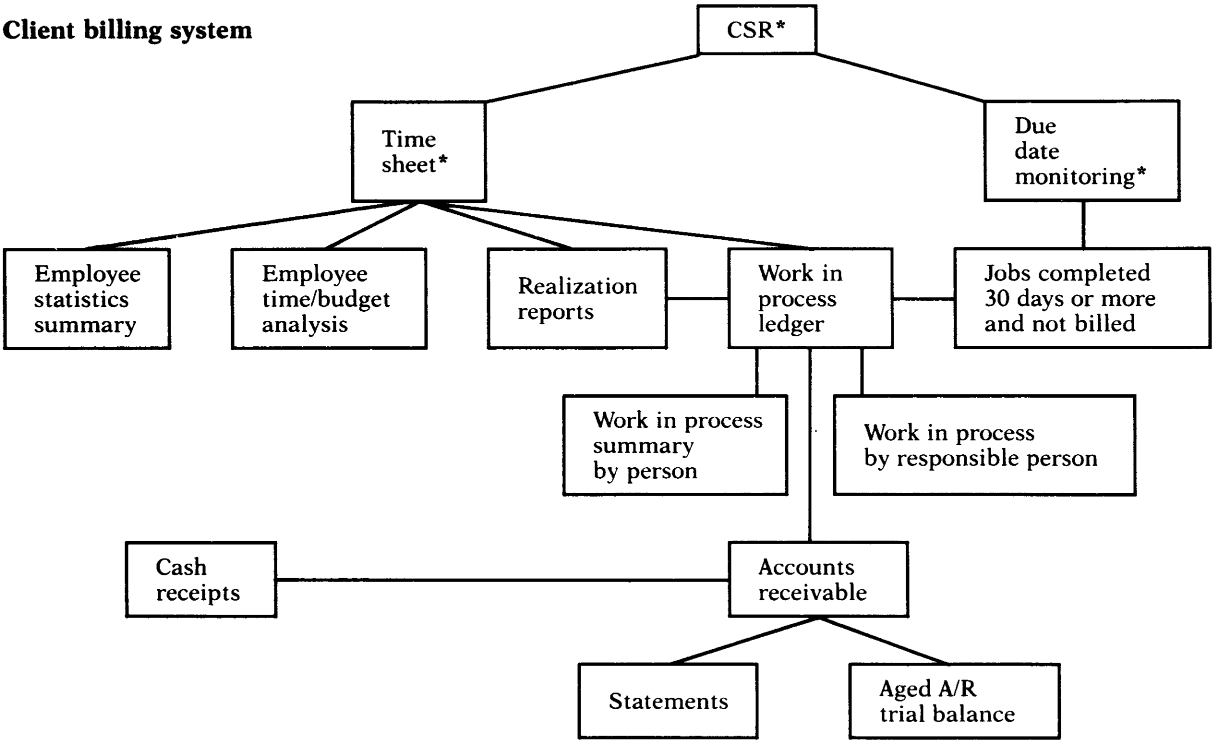
Line #39 —

DRAFT:	By	Date
Prepared		
Footings, computations, cross-ref. checked		
Manager's review		
Approved for release to report department		
Shareholder's review		
Preissuance review		
Approved for final release		

REPORT:	By	Date	Hours Actual	Hours Budget
Received & logged				
Typing				
Proofed & footed				
Corrections				
Corrections verified				
Reproduction/asse.				
Quality control				
TOTAL HOURS				

Exhibit III

Client billing system



*Documents, reports and functions applicable to client-service monitoring system.

according to the responsible person and commitment date. By noon, every Friday, the managers and shareholders mark off the completed jobs on their respective printouts and the data processing department generates due-date reports from the data on both new and completed jobs. We also prepare a monthly report for the shareholders' meeting. This lists all engagements that have been completed for more than 30 days but have not been billed. For each listing continued in the report, we require an explanation that is satisfactory to the board of directors.

We have found that this system gives us timely and effective analysis of work in progress and helps ensure prompt billing. ☑

–by Terry L. Walker, CPA
Owensboro, Kentucky

FEES, BILLING AND COLLECTION

May 1985

In a presentation at the AICPA practice management conference in Las Vegas last year, Morris L. Shifman, a Springfield, Ohio, consultant to the profession, discussed businesslike approaches to fees, billing and collection. For example, while most firms have uniform rates for each partner and staff member, Mr. Shifman thinks that some flexibility might be considered. He says that sometimes extra time is needed to learn the intricacies of new businesses or to complete complicated engagements, and this may justify deviation from standard rates.

Mr. Shifman suggests adopting a "value billing" philosophy—i.e., determining the value of the service to the client and adjusting the fee accordingly. The service may be fairly priced. On the other hand, you might decide that certain work was performed by an overqualified person and consider marking the bill down. There are occasions, however, when a markup may be in order, such as an engagement that favorably affects the client's bottom line.

Bills should be sent promptly if prompt payment is desired. Another reason that Mr. Shifman gives for timely billing is that if the engagement is fresh in everyone's mind, it is easier to determine whether any dissatisfaction expressed is really about service rather than price.

Mr. Shifman does not advocate listing specific details of services performed on the bill. He does not think clients are particularly interested in such items and believes the use of broad categories works just as well.

In his presentation, Mr. Shifman reminded participants to follow up unpaid bills with monthly statements, and to send interim bills on engagements that last over one month. Many firms now impose a service charge on accounts that are past due, but Mr. Shifman wonders whether this could suggest acceptance of late payments.

Being firm with clients can help get past-due bills paid, but, perhaps, the time to be firm is when accepting the engagement. If engagement letters are used, and if the fee and payment terms are discussed up front, collection problems are less likely to arise.

Mr. Shifman also suggests formally evaluating clients every year. He recommends having staff members participate because they may have a different relationship with clients and can express other viewpoints. "Then," he says, "you can take steps to improve service and communication with clients where needed."

BILLING AND COLLECTION

September 1980

The billing operation is an essential part of any effort to achieve fees that are consistent and equitable to all concerned. Section 203.01 of the *AICPA MAP Handbook* lists the following five important elements of a well-planned system.

- ☐ *Account for all services adequately* through the maintenance of proper records.
- ☐ *Systematize the internal operations of the firm* through the establishment of regular procedures.
- ☐ *Help insure full collection* by billing promptly.
- ☐ *Evaluate quality and value of services performed* when the bill is being prepared.
- ☐ *Establish and maintain working capital* by keeping receivables current and not allowing unbilled services to accumulate.

The realization of standard affects and, in turn, is affected by the billing rates themselves and by bad accounts. Obviously, a firm can realize 100 percent of standard if its billing rates are low. However, the firm will probably be more profitable with higher billing rates and lower realization. As one practitioner says, "A high realization of standard with high billing rates should be the target even if the firm falls short from time to time."

We asked members of our editorial advisory committee for their views on topics such as realizing standard, establishing billing rates for staff, partners who won't cooperate, minimum amounts, variable rates and the effects on client relations, etc. Here are some of their comments.

Carol DeHaven, Springfield, Mo.: We believe the key to success in billing and collection is to have a clear, consistent firm policy, which is understood and accepted by all members of the firm. We take special care to help our clients understand how and when they will be billed and when we expect to receive payment. We believe the engagement letter is a convenient means of documenting this understanding; therefore, we use an engagement letter for every client, whether our service involves monthly consultation or only an annual tax return.

Our engagement letter specifies our standard rates and charges and, upon client request, we will estimate the fee. Our statements to clients follow the format of the fee schedule provided in the engagement letter so that clients can readily see that the fee charged conforms with our written agreement. It has been our experience that this approach minimizes collection problems because clients understand the basis for the fee they are charged.

Re: partner cooperation—the key is careful selection of partners. (See "Preventing Partnership Problems" in the March 1980 issue.)

Robert Israeloff, Valley Stream, New York: We do not believe in variable rates for each employee. A person is worth so much per hour whatever he or she is doing, and a variable rate would give a partner too much leeway in telling a staff person to affix his lowest rate so that a long-standing client can be billed less.

Our billing rates are a minimum of three times the hourly wage of each employee — usually rounded up by 10 percent to account for nonchargeable time and fringe benefits.

We set our rates realistically so that we can collect 100 percent of standard (last year, we realized 98 percent). This year, we implemented a number of quality control and review procedures which add substantially to the time on each job and which cannot be passed on completely to the client. Nevertheless, we think we will realize over 95 percent of standard.

Sidney Jarrow, Chicago: All jobs should be billed not less than monthly by all partners. Billing on individual 1040s should go out with the 1040 and not after the tax season.

Work in process as well as accounts receivable should be aged, and both should be reviewed monthly by a review committee. A partner should write an explanation of anything over 60 days old and write-downs in excess of $200 should be approved by the committee.

Engagement letters should state that billing will be done monthly, and all delinquent account collections should be the responsibility of one partner.

Ronald Russell, Springfield, Ohio: We calculate average hourly rate, percentage of variance from standard, etc. on every billing issued and maintain our work in process inventory at extended dollar units and time units. At the beginning of each year, we establish a budget for percentage realization of standard and constantly monitor our results against it during the year, taking corrective action if necessary.

We normally bill once a month. However, during the January to April period, we go to semimonthly billings that coordinate with our time period closings of the 15th and 30th. All billings are prepared by partners and approved by a partner other than the preparer. We establish minimum amounts for tax returns and one-time services.

An idea for getting partners to cooperate in billing and collection is to have a monthly report of each partner's total billings, mark-ups, markdowns, billable hours and to age each partner's accounts receivable, etc. A poor performance would affect the partner's drawing account and compensation.

A basic viewpoint on how billing is handled is that, in most cases, accountants bill only by hours and don't take into consideration factors such as what was accomplished, how the client benefited from the service or the conditions under which the work was performed.

While lip service is given to these factors for variations from standard rates, they seem, in practice, to relate more to write-downs than write-ups.

STEPS TOWARD MORE EFFICIENT BILLING

September 1981

Getting bills out on time and minimizing write-downs is crucial to the survival and growth of every professional firm. As a general rule though, we CPAs find billing very onerous. We would far rather be performing fee-generating services than actually billing clients for those services. This is understandable when one considers our professional training. We start our careers performing client services and the emphasis is on billable hours, subject, of course, to quality service. Not until we become partners or managers, or in some firms seniors, are we actually involved in billing.

It is a fact of human nature that we tend to do those things we like to do and neglect those things we don't like to do. As a result, many firms have problems getting bills out on time and minimizing write-downs. Our firm was no exception.

Not long ago, I attended a management of an accounting practice conference and returned to the office with an idea which I thought might improve our billing system. I will describe our old method, the system we changed to and what has resulted.

The old method

We obtained our raw billing sheets from the computer two to three days after the end of each month. These printouts were then distributed to partners and senior staff on a client responsibility basis for billing. As a rule, we got these billing sheets back to the clerk who typed the bills between five and fifteen days after the first of the month. During tax season, there were times when the billing was not completed until the twentieth of the month. After the bills were prepared, they were reviewed by the managing partner and then mailed to clients.

The problems with this system were that

- ☐ The bills were not getting out in a timely manner.
- ☐ We were not effectively controlling write-downs, which were essentially left to individual partners.
- ☐ New partners and senior staff members were not getting the benefit of the senior partner's experience in billing, both in the wording of the bill and in learning how to bill at standard rates.

The new system

In the system described at the MAP conference, all partners responsible for billing meet once a month and prepare the bills jointly. We decided to try something similar and the following is our approach.

On the third or fourth working day of each month, the five partners in our firm block out two hours starting at noon. We go into the library, have lunch brought in and do the billing together. By the time we start we have each had the raw billing data on the clients for whom we are responsible for at least half a day. We are thus familiar with the data and are able to discuss any troublesome bills with other partners and get their input. None of us finds it easy to justify a write-down to our partners. We found it much easier to write down a bill in the privacy of our own offices.

The results to date

The first month we tried this method, we increased our billing by about 12 percent over what it would have been had we done it the old way. A typical discussion during that first session was along the lines of

Partner A: The XYZ Company's billing at standard is $950. It was only $650 last year, so let's bill $750.

Other partners: Why the increase at standard rates? Was it inefficiency on our part or was the work more complicated and our rates higher this year?

Partner A: Well, I guess it's a combination of all these factors. I imagine a bill of $900 would not be unreasonable.

By the end of the day on which we have had our billing meeting, the billing sheets are on the typist's desk ready to be typed. By the end of the following day, which is usually the fifth of the month, the bills are in the mail.

This system has provided us with

- ☐ Increased cash flow because of the more timely billing.
- ☐ Higher gross revenues.
- ☐ Better communication among partners over billing problems.
- ☐ More uniformity in billing.

And an interesting thing is that we have noticed absolutely no change in our clients' reactions to their bills since we instituted this new system.

—by Walter F. Reardon, CPA
Upland, California

LETTER TO EDITOR

November 1981

I read with interest the article, "Steps Toward More Efficient Billing" in the September issue of the *Practicing CPA*. While I basically believe that any system which produces the desired results is a good one, I would like to add a few comments on certain aspects of the article.

We CPAs hold our counsel and services in high esteem, but not high enough, it seems, to bill fairly and promptly. We tend to decide how our clients will react to bills before they have even seen them. And then we rationalize why perfectly valid bills should be marked down.

I agree that timing is imperative. Getting raw data in, getting the summaries back and then billing promptly are essential to the success of any system. However, I do not agree that a billing meeting is necessary. In most instances, billing is simply a discipline of standard rates accompanied by behavior modification. This last named activity can be a rather painful process at first, but it can end up, as it apparently has at Mr. Reardon's firm, being a pleasurable and profitable experience. In our firm, the same results were obtained in a somewhat different manner.

We require each PIC (partner- or principal-in-charge) to bill fairly and promptly. By fairly, we mean fair to the client and fair to the firm. The necessary discipline and peer pressure results from action taken by the three-member executive committee. Each month, when the time and recordkeeping report is received, this committee meets to review, authorize or reject the following items which must be submitted by all PICs:

- ☐ A written explanation as to the status and the collection efforts being used on all accounts receivable over 60 days old.
- ☐ A written explanation as to why work-in-process over 60 days old has not been billed.
- ☐ A written request for approval to write off accounts receivable in excess of $200. This must cite the reason for the request and give the total amount billed to that client for the year.
- ☐ A written request for approval to write down work in process in excess of $200. This must cite the reason for the request and give the total amount billed after the write-down.

The executive committee is not a rubber stamp group. Requests are periodically rejected or instructions are given to a PIC to stop doing work for a client until some payment is made. It is amazing how having to write the requests motivates one into getting rid of old items and into handling others on a more timely basis. And even clients, knowing of a forthcoming meeting, are sometimes motivated into mailing their checks promptly.

In our best year after this policy was instituted, our cash basis income exceeded our accrual basis income. This made us aware of our lack of discipline in prior years. We realize, too, that if the policy is to continue being as effective, motivation and discipline must be maintained. If not, a fast deterioration will occur and dollar-flow rigor mortis will again be upon us.

–Sidney F. Jarrow, CPA
Chicago, Illinois

COMPUTERIZED TIME AND BILLINGS—GETTING A GOOD RETURN ON YOUR INVESTMENT

September 1983

One important message I got from a session at the AICPA Private Companies Practice Section Conference in New York last spring, is that the best way to obtain a favorable return on investment from your computer is to use it in the management of your own practice. This doesn't mean that you shouldn't use your computer for client write-up, forecasting, etc., but that you will typically get a better return if you first concentrate on applications in your own business.

Time and billing is often the first application that comes to mind. However, before you rush out to buy the software for a time and billing system for your practice, take some time to accurately determine your needs.

In our practice, we have used three different time and billing systems during the past seven years and have found that in the world of computing, planning is especially important and failure to do so can result in some unpleasant surprises. At times, though, even careful planning doesn't avoid surprises as we recently discovered.

Having just purchased an additional computer for our practice, we decided to convert to an updated time and billing program. We carefully outlined our size and other needs including number of clients and projected growth rate, and after careful analysis of our options, we chose a system from a reputable, nationally known software house. The system we purchased had all the bells and whistles, and we were confident it would more than fit our needs.

After the software arrived, we spent considerable professional and clerical time learning how to use it. We even entered sample data into the system and tested its application. Then the big decision was made to enter all of our client data. Entry of client information was less than half finished when the system locked up. An urgent (and nervous) call was made on the toll-free hotline to the software house. We were assured that the problem could be resolved. However, after further discussion, we discovered to our dismay that the system simply did not have the capacity for our practice.

What went wrong? Why, after such careful planning did we not recognize the limitations before we bought the system? The reason was that we never discussed our needs with the technical staff of the software house before we bought the package. We dealt solely with sales people who, although they had good intentions, only had a general knowledge of the system's capacity. Had we talked to the technical staff, much of the time and expense we incurred could have been avoided altogether.

The software house was very cooperative and sympathetic to our situation and, in fact, eventually refunded our money. We did find a compatible system for our practice and, in doing so, devised the following list of essential points to be considered when selecting time and billing software.

- ☐ *Plan for growth.* When you specify your needs, allow for several years of growth in the number of staff members as well as clients.

- ☐ *Discuss your needs with the technical staff of software houses.* Assure yourself that they understand not only your size but your average number of monthly transactions per client and cyclical variations in your activity, etc.

- ☐ *Make sure that you can operate the system without excessive changes of program and data discs.* Some floppy-disc systems require separate program and data discs for work in progress transactions versus billing and accounts receivable. Others operate simply with two diskettes, one for the program and one for data. Either system may work for you, but you should be aware of the differences and that changing discs can be time consuming.

- ☐ *Get references.* The best test of a system is whether it really works in practice. Therefore, ask for references of several current users of the system, preferably users in your area so that you can actually see the system in operation. We find that most CPAs are more than willing to share their knowledge and experience with fellow practitioners.

- ☐ *Know what you are looking for.* A valuable source of information is the AICPA computer service guideline, "Guidelines to Assess Computerized Time and Billing Systems for Use in CPA Firms." This publication is well worth its price of $6.00 as it provides a detailed description of various elements you should require in a computerized time and billing system. It also contains checklists and forms for use in developing specifications for your practice. If you do no other planning for your time and billing system, read this guide.

I agree that the best return on investment on an in-house computer is in the area of practice management. With proper planning, a time and billing system is a good place to start.

–by Keith J. Graeve, CPA
Omaha, Nebraska

USING AUTOMATED BILLING PROCEDURES TO REDUCE PROCESSING TIME

April 1990

It is axiomatic that bills should be sent to clients promptly if prompt payment is desired. Realization can often be improved, too, if the details and value of an engagement are fresh in everyone's mind.

About one year ago, our managing partner, Andrew Chavkin, suggested that we could improve cash flow if we could cut down on the time it took us to process invoices. After determining where the bottlenecks were occurring and what was creating them, we realized that significant time could be saved if we automated the process. Because each partner at Sterling, Nappen & Chavkin had always used customized invoice narrative and formats, the change to automated procedures required some initial adjustment. Once everyone became used to the new system, however, we found that we were able to reduce the processing time by several days. Following are some suggestions for streamlining the process, based on steps we took at our firm.

- ☐ *Standardize.* It is essential to reduce the number of customized invoices in the system. If each partner maintains individualized ways of describing the same services, you will never reduce processing time. Review previous invoices and select phrases suitable for frequently performed services. Don't try to include all services, though. The automated process should allow for special-service needs.
- ☐ *Simplify.* Use wording which concisely but accurately describes services rendered. Stay away from lengthy descriptions where possible. You can always supply details or supporting documentation upon request. If you deliver the invoice in a timely fashion, however, clients are more likely to remember the work performed.
- ☐ *Format.* Design invoices to meet the needs of clients, partners, *and* the people who process the bills. Keep in mind that the data-entry operator has to enter information in the sequence required by the processing equipment.

  If your firm uses a microcomputer for this purpose, consult with the data-entry operator to make sure your new invoice matches the machine's input sequence. You can reduce both processing time and the risk of errors if the operator reads and enters data in the appropriate sequence.

  If you process invoices on a typewriter, the typist should still be able to do the job quicker once familiar with the new standardized format. Check with the person responsible for processing invoices before approving a format.

Five essential features

To ensure that the invoices are standardized and the process automated as much as possible, we devised a set of billing memoranda geared to various services we provide (see exhibit on the facing page).

Each phrase describing a service is assigned a number. The manager or partner preparing the invoice circles the number corresponding to the function performed. The data-entry operators then just enter the numbers. This saves time and eliminates the need to continually proofread all narratives. As can be seen in the exhibit, the memorandum accommodates specifics such as special meetings, telephone conferences, and yearend dates.

The format allows flexibility in the order in which phrases are to appear on the invoice. The operator just enters the specific numbers in the order indicated. Space is left for subtotals, to record individual services rendered in case itemized billing is required, to show who prepared, processed, and proofread the invoice, and whether it should be mailed, hand delivered, or held in the office pending the client's visit.

Tips to ease the transition

Success at implementing the new system depends on everyone understanding and supporting the concept. So, go over the billing procedures with all concerned and explain the benefits that will result. Include billing instructions on invoice memoranda to remind people of the procedures. At the close of each billing period, give those preparing invoices a supply with details of their work in process.

If you find you are frequently performing new services, modify the memoranda to include phrases that adequately describe them. Meet with individual partners to discuss any problems that occur, but keep in mind that firmwide consistency is essential. Exceptions just slow the processing of invoices.

We have experienced considerable benefits since changing to a standardized, automated process. The quality and timeliness of our invoices has improved.

Billing memorandum
Accounting and nontax services
(please print)

Client: ____________ Account no. ____________ Partner ____________

Invoice status (check one)
___ Final chargeable ___ Final nonchargeable ___ Not final

Billing instructions:

1. Circle all applicable billing codes.
2. Indicate the sequence of billing descriptions for the printed invoice to the left of each code.
3. Enter period, if required.
4. Indicate subtotal dollars to the right.

Order	*Code*	*Description*	*Subtotal*
___	469	Quarterly payroll tax returns Quarter ended ______	______
___	471	Annual payroll tax returns and W-2 fiscal yearend ______	______
___	261	Accounting & tax services month ended ______	______
___	262	Accounting services for the yearend ______	______
___	270	Interim billing in connection with audit	______
___	271	Interim billing in connection with review	______
___	272	Interim billing in connection with compilation	______
___	399	For the period ______ through ______	

Order	*Code*	*Description*	*Subtotal*
___	264	Audit of financial statements yearend ______	______
___	266	Compilation financial statements yearend ______	______
___	267	Review financial statements yearend ______	______
___	268	Analysis of transactions period ended ______	______
___	416	Prepare form SS-4	______
___	417	Prepare form CIS-1	______

Charges:

Invoice amount: $ ______

Out-of-pocket expense (761) ______

Total billing $ ______

Processing:	*Initials*	*Date*
Invoice preparation	______	______
Partners approval	______	______
Verified	______	

Special handling ____________

Partners take less time to prepare bills, and there has been a compression of data entry, word processing, and proofreading time. We have also seen an improvement in accounts receivable. For the partners and staff of Sterling, Nappen & Chavkin, the results are well worth the effort. ☑

—*by* **Jayne E. Osborne,** *Sterling, Nappen & Chavkin, 354 Eisenhower Parkway, Livingston, New Jersey 07039, tel. (201) 992-9199*

Editor's Note. Ms. Osborne is director of administration and MAS consultant for Sterling, Nappen & Chavkin.

QUESTIONS FOR THE SPEAKER (MAINLY ABOUT BILLING)

April 1984

One of the questions invariably asked at practice management conferences concerns providing firm financial and partner compensation information to staff. While a show of conference participants' hands reveals that some practitioners don't share any financial information, an increasing number are apparently prepared to share quite detailed information with their staff.

Some practitioners think the staff would find out anyway, or far worse, make some highly inaccurate guesses, so they think they might as well provide the information. And other firms believe that one of the best ways to develop staff morale and a feeling of belonging is to share their financial statements with staff members.

Some firms make partner compensation known as well, while others believe that individual compensation is really a private matter and are willing to reveal partner compensation only as a total amount for the firm.

One CPA's thoughts about sharing financial information

H. W. Martin, a retired Georgia practitioner, believes there are benefits to sharing financial statements. Here are some of his comments.

The statements should be distributed in a timely manner, not six months after the year-end; and they should be comparative, with projections for the ensuing year included if this is possible. And to mark the occasion, it is nice to have a staff breakfast or something special to precede the meeting at which the presentation is made.

Some firms make the statements available only for the duration of the meeting. However, this somewhat defeats the purpose because there is a connotation of distrust in this action. Besides, most staff people can reconstruct the statements fairly well from memory. Obviously, everyone should be told that the statements are confidential and should not be discussed indiscriminately.

Don't overlook the balance sheet when discussing financial matters

Although the income statement will be of most interest, the balance sheet should not be overlooked. Comments as to the number of unbilled work days represented by the work-in-process and to the number of days of billed work in the accounts receivable will help staff members understand the necessity of completing work promptly and let them know how important collections are. If the firm has made substantial investments in fixed assets, this might also be discussed to help staff realize how much profit has been reinvested.

A factual optimistic report to the staff builds morale. People like to be associated with, and feel that they have contributed to, a prosperous firm with a bright future.

Every firm occasionally has a poor year. The discussion leader should be prepared to trace the disappointing results to economic conditions, the loss of several key clients or to whatever was the cause. At the same time, the firm's plans to effect a recovery should be emphasized and the staff's assistance should be solicited to accomplish this. Another idea to keep in mind if the firm has had a bad year is to release an interim statement with the year-to-date results. This will be very interesting to the staff.

Retaining a good staff is essential to the success of any firm. Sharing the firm's financial statement with staff members is one of the ways to do it.

Practitioners frequently ask questions about which items should be billed

There are always questions about billing too. For example, should travel time, initial meeting time or your time when a client takes you out to lunch be billed? And what about phone calls? Practitioners have different ideas about billing these items.

Sidney F. Jarrow, a Chicago practitioner, says it is a matter of judgment and that, generally, a portion of the time, if it is other than social, will be billed. "The rate will be the regular billing rate," he says. Richard A. Berenson, a New York City CPA, replies, "We bill travel between the hours of 9 A.M. and 5 P.M. but not travel between clients. Phone calls and initial meetings are billed, and if there are substantive discussions when clients take partners out to lunch, clients are billed for the partners' time.

Robert L. Israeloff, a practitioner in Valley Stream, New York, says "We bill phone calls, but not initial meeting time, at standard rates." And Daniel S. Goldberg, a CPA from Livingston, New Jersey, responds "We bill for travel time and phone calls which take place during working hours but not for initial time or when the client takes us out to lunch." Mr. Goldberg adds, "No separate itemization is made on our billing to the client for the chargeable time: rather, the time is simply included in our total charges at aforestated billing rates."

All time should be recorded whether or not it will be billed

Obviously, if a firm is to have the information to properly review and plan its financial well-being, everyone's time must be fully recorded. Time is a CPA's stock-in-trade. This means that travel time during office hours, telephone calls, initial meeting time, excess time lunching with a client, etc., should be recorded whether or not the time will be billed. In fact some firms attach great importance to recording time that they know won't be billed, the reason being that it enables them to see the amount of such time involved and to take steps to reduce it.

Apparently, many firms are now recording their time by accounting for it on a 40-hour week, 52 weeks a year, plus any overtime hours that are worked. Vacations, holidays, sick time, CPE courses, administrative and unassigned time are all recorded and the firm thus has a common base on which to compare everyone's time. Using computers, such nonbillable items as office and administrative time can be classified and thereby reveal if individuals are engaged in worthwhile nonbillable tasks. Firms think this system of accounting can pay off in better time utilization.

A basic daily time sheet can serve three valuable purposes

Although most firms assemble time on a weekly or biweekly basis for input into the time records, Mr. Martin suggests personnel complete a basic daily time sheet that can be given to a partner first thing the next business day. He says this sheet should not only show the time spent on various clients or the type of nonbillable time, but space should also be provided for a brief description of the work done. Mr. Martin says this sheet then serves three valuable purposes by

- ☐ Assuring the prompt recording of time. It is easy to forget how time is spent and thus lose the revenue from the numerous small charges that arise in a local practice.
- ☐ Providing current information as to work progress.
- ☐ Uncovering the office time of individuals who have plenty of work to do but who always manage to have an hour or two in the office everyday.

Good time records used intelligently can help firms increase their profits. They are the only sure way of learning which clients are not profitable and how much time is actually spent on nonproductive activities.

A frequent and related question concerns the amount of detail to write on invoices

A related question that is frequently asked is "What details do you include on invoices to clients?" Some practitioners respond, "As little as possible—usually just a description of the work and an amount," or, "Depends on what the client wants. Never give detail in excess of what the client wishes." Some firms leave it up to the individual partners to determine what is preferable. They say that partners write invoices differently. Some partners write with much detail and some with very little.

Carol S. DeHaven, a Springfield, Missouri, practitioner, says "Our invoices detail charges in four categories: (1) partners' time, (2) staff time, (3) clerical time and (4) related costs of computer charges, copying, postage, etc. Ms. DeHaven says that the format for the invoice corresponds with the rate schedule provided with all engagement letters. This rate schedule is updated annually.

Mr. Martin believes that every firm should have a written policy on invoicing, including the descriptions to be used for billing different types of work. He says that the descriptions can be given code numbers which will save partners' time in preparing the invoices for typing. "Most invoices," he says, "can be handled through the use of 12 to 15 different descriptions."

Robert L. Carr, a Canton, Ohio, CPA, says, "Invoices are developed in a number of ways in our office. In some cases, we simply use a standard description which reflects the period under examination, the type of examination and a general listing of the tax work performed. In other cases, where the work tends to be of a different nature or where there are many short-term elements charged to a client, we may use a system similar to that used by many attorneys, i.e., a daily listing of conferences and telephone calls."

Adapting the invoice to the client

Mr. Carr says that a daily listing is sometimes more successful in dealing with a client who may have forgotten the number of times he has telephoned or been called, the number of conferences held or the special work that was involved. He believes that the type of invoice must sometimes be adapted to the client and, possibly, to a particular partner's or billing person's style. "In most cases," he says, "we believe it is better to provide a larger, more detailed description of the work done than a one-line description. Nevertheless, there are probably instances in which a one-line description may be appropriate and represent the best client relations."

Carefully worded invoices will help prevent misunderstandings with clients. And many practitioners think that while the nature of the work should be stated without undue detail, the use of well-worded and uniform descriptions will also save the billing partner's time.

WHY NOT TURN "CASUAL CONVERSATIONS" INTO BILLABLE EVENTS?

January 1988

During a conversation at a recent MAP conference, one of the practitioners mentioned that he had regular meetings with clients, but that these were usually just casual discussions and did not really amount to much. He indicated that there was a need for a specific form that would facilitate the follow-up of such meetings. While I did not know of such a form, I agreed that it seemed to be a good idea.

I pointed out that these meetings should be considered a valuable part of any engagement—that the discussions are probably of greater value to the client than the financial statement or tax return that is being delivered or picked up.

If we accountants are going to convince ourselves that we do indeed provide consulting services, we first have to get away from the "finished piece of paper" mentality. We have to free ourselves from thinking that preparing financial statements, tax returns, etc., is the only type of work we do. We have to convince ourselves that what we say is just as important, and in some instances more important, than what we do.

Once we change the way we view our services, why not make the notes we take at client meetings a valuable part of our work papers, build the meeting into an engagement, and turn it into a billable event? A meeting follow-up form might help us do this.

You can design your own form such as the example. To be practical, the form should, at the minimum, include the following items: client name, client number, location of meeting, time started, time ended, items you wish to discuss, items the client wishes to discuss, action you are to take as follow-up to the meeting, action the client is going to take as follow-up to the meeting, and any other items that come to mind.

One other suggestion is that you make it clear to clients that you are providing a valuable service in meeting with them. You may or may not bill for this service—but don't assume that you won't. You *hope* that something will be accomplished that will enable you to bill.

CPAs' services for clients might be likened to a doctor's visit. The patient hopes the diagnosis will be that nothing is wrong because, among other things, it will cost more for the doctor's additional time. The patient never expects to obtain the initial service for nothing, however.

We have to communicate to our clients that every meeting is important and that our time and services are valuable. No discussion of client business is informal or casual.

Using the form signals the beginning of an engagement. It formalizes the structure of the meeting and is a record of it. The purpose of the worksheet is to turn the meeting into a billable event. It marks the beginning of service to the client.

The form should also have space in which to note whether the minutes are to be typed or photocopied, and if they are to be mailed or delivered to, or picked up by the client.

CLIENT MEETING PLANNER/FOLLOW-UP

CLIENT NAME ________ CLIENT # ________ DATE ________

LOCATION ________ TIME START ________ TIME END ________ ELAPSED TIME

IN ATTENDANCE: ________

OUR AGENDA: ________ CLIENT AGENDA: ________

OUR FOLLOW-UP ASSIGNMENT ________ DATE

CLIENT FOLLOW-UP ASSIGNMENT ________ DATE

MINUTES:

__ TYPED __ PHOTOCOPIED __ MAILED __ DELIVERED __ PICKED UP

COPIES TO: ________

__ TO BE BILLED ________ MEMO BY: ________

As a method of keeping the whole firm up-to-date, it might also be a good idea to indicate who else in the firm should receive copies of the minutes for further follow-up service to the client. It is important that we continually be on the alert to cross-sell between partners or departments in the firm. Remember, clients often don't know the full scope of services your firm renders. You have the duty and obligation to let them know of their needs and your capabilities.

Selling is not an unacceptable word. Selling skills should be part of the marketing arsenal of every CPA firm today. In fact, it is truly amazing how easy it is to obtain additional business from present clients simply by making yourself available and asking how you can help. Following up on client meetings can result in closer bonds with clients and increased profits for your firm. ☑

—by Morrey Shifman, CPA
Springfield, Ohio

INCREASED REALIZATION THROUGH REVIEWED BILLINGS

October 1986

One of the built-in problems facing many practice units is billing timidity on the part of people responsible for that function. Our basic natures seem to provide us with a high loyalty factor, which is most often directed to our clients rather than to the profit goals of our firms. As a result, we grasp every possible excuse to write bills down from standard. How many times have you heard billing heads say, "We were learning on this job" or "It was the staff member's first effort in this industry"?

To be both meaningful and profitable, standard rates should have validity in terms of marketplace acceptability and achievement potential. Surveys of our industry over the years indicate that a practice unit can achieve highest profitability when its realization rates are consistently hovering around the 92 percent level.

There is a process, however, that can be a vehicle for increasing realization by about four percentage points a year. (That's 4 percent more profit a year.) While not easy because it requires much individual and collective discipline, the process can be worth the effort involved. Here's how it works.

All individuals responsible for billing are required to

- ☐ Have draft billings (annotated computer runs) ready by a given day each month, with no excuses accepted. (Some practice units impose penalties for failure to comply.)
- ☐ Be in the office on the following day to meet with the billing review committee to determine the final billing amounts. The committee has the last word on the amounts and timing of billings and should discourage undue write-downs and encourage appropriate write-ups.

Experience shows that after 2 or 3 months of gaining familiarity with each other's client situations, the meeting with each billing head will last approximately 30 minutes.

The billing review committee comprises two or three individuals who have billing responsibilities. Each should serve 2- to 4-month tours on a rotating basis, so that everyone with billing responsibilities serves on the committee during an 18- to 24-month period. Terms should be staggered to provide continuity in the committee's efforts.

If managers and other staff members have billing responsibilities, they should serve on the committee. The committee, however, should always have at least one partner serving on it at any given time.

The process should continue in perpetuity. The initial goal should be to achieve a 92 percent overall realization rate for the practice unit. This may take a while if starting realization levels are low. Firms should anticipate realization increases of about 4 percent in 8 to 12 months of concerted effort.

When the 92 percent realization level is achieved, continue the process so that realization climbs to the 94–95 percent level. At that point, increase standard rates so that, arithmetically, realization is reduced to about 88 percent. Continue the process to once again achieve the 92 percent level, and so on.

Quality of service and product will tend to rise over time as the process continues. Once again, our basic natures come into play. We find it difficult to increase fees without also improving our quality of service, and we will tend to upgrade our skills to match our higher standard rate levels. In addition, increasing profitability facilitates greater investment in training for everyone in the firm.

Each billing head will gain knowledge of other firm clients. This results in better understanding of the practice problems of colleagues, enables cross-fertilization of skills and knowledge among the executives of the practice, and provides safety in the event of a colleague's death or disability.

Is the process worth the effort? One managing partner of a local firm reported these results in the first 18 months of applying the process: over $160,000 in increased profits, earned at a rate of about *$753 of profit per hour* for the extra time the process took over the previous system. ☑

—by Don Istvan, CPA
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VALUE BILLING

November 1987

Billing is an attitude, not a process! If this statement seems rather startling, consider for a moment the following questions and comments.

Do you deem yourself to be an average accountant? If you do, you will probably receive average fees for your services for the rest of your career. Do you sometimes consider yourself to be smarter than other people? If you do, why do you continue to bill at the same hourly rate? Here's another question. Is every hour of your working day worth the same amount of money? I don't believe so. I would answer, "definitely not."

When asked what their time is worth, CPAs invariably give their hourly rates. The concept in value billing, however, is that every hour is not worth the same amount of money. If you come up with a great idea—something unusual or something that can make or save the client thousands of dollars—you should bill more than your hourly rate. You should do this even though the idea may have come to you instantaneously. *(Editor's note: Value billing is not to be confused with contingent fees.)*

When asked why they don't bill more, CPAs invariably say, "I have to be competitive." In reality, though, you don't have to be competitive if you do better than average work. This means going beyond routine tax and audit work to developing a niche and applying creative thinking on the client's behalf.

In billing, you have to constantly reassure clients that you are being fair with them. If the service is an average one, they should know that they are paying the same as everyone else. If you come up with something unique, however, the client should know that the fee will be higher. Our engagement letter gives our rates, but it also states that under certain circumstances, we will use value billing.

The main point to keep in mind is that you must explain to people that you aren't average. For example, a client may say that you have quoted $10,000 for an audit but that someone else will do it for $8,000. He would love to have you do it but . . . and waits for you to say you'll do the engagement for $8,000. I tell such a client that if he wants an average service, I'll help him shop around to get an even lower price; my services are not average, however, and I will not budge from what I think is a fair fee for good value, simply to meet the competition.

Time is not the most important factor, although every firm tends to look at billable hours and at rates per hour. Just think, though, how you actually determine the time spent on an engagement. Do you include the time spent thinking about the engagement and the time spent brainstorming with other people? You don't have to have a pencil in your hand to think. And do you charge for the time spent learning your professional skills?

Current practices are to bill actual time at standard rates or to employ what I call the "Is it OK?" method. This second technique is when you hand a client a bill and then ask if it is OK. You are really saying, "You had better look at it, there might be something wrong." Don't raise any doubts. You would not have sent the bill if you did not think it was correct. By asking clients if they think the bill is fair for the service rendered, you are letting the clients set the fee.

In value billing, a lot of what you do is not immediately visible or is not measurable. For example, I do a lot of estate work. Many accountants do. Much of this work is mechanical, but there are also plenty of creative opportunities. Perhaps there is a small percentage of CPAs who can create or control opportunities in this area. Nevertheless, there are opportunities to value bill.

Marking down is terrible

If you must mark down, do it before you send the bill and let the client know. Write on the bill that you have marked it down and the reason why. For example, you might say, "We billed you $1,000 but we had someone on the engagement whom we are training, and we have deducted $100." The psychological effect of this is enormous. Clients think you are fair.

On the other hand, if the client complains that a bill for $1,000 is too high, and after some haggling you settle on a fee of $900,

- ☐ You have told the client that from now on every bill is negotiable.
- ☐ You will leave the client with a doubt as to whether you have overcharged him in the past.
- ☐ You will make the client wonder whether you are trying to get back the money you marked down every time he receives another bill.

There is nothing wrong with a high bill, provided that you give good-quality, professional service.

Another method commonly used is to compare the current bill with the previous one in the belief that there should be some relationship between the two. This is not necessarily true because circumstances—reporting requirements, taxes, etc.—change from year to year. What you should do is look at the current bill to see who was working on the engagement, and if there is any reason for you to mark it down. If there is, mark it down and write the reason on the bill before you send it to the client.

The psychological barriers to value billing

Perhaps the major barrier to value billing is that the average CPA is afraid that clients will complain that their bills are too high. If clients complain, CPAs fear that their partners will also complain that they are billing too high and that clients might leave. Just think of the thousands of unbilled dollars that have been lost because of these fears.

Our education tends to make us negative thinkers. We are defensive rather than creative—taught to look for what is wrong rather than what is good or correct. Those areas where we can benefit clients are where creativity has value.

To overcome the barriers, we really have to change our personalities. We have to learn to look for ways we can help the client, ways the client can see. Generally, when you do that, you don't have trouble billing the service. One seldom gets complaints value billing for estate planning services.

We have to get away from negative attitudes toward billing and collection, away from negative peer pressure, the wish to avoid controversy, and what I call the "Maybe" syndrome: Maybe we took too much time, maybe we made mistakes, maybe we assigned the wrong person. The list goes on. It has nothing to do with reality and is a form of rationalization that people use to avoid value billing.

So, what's this all about?
Value billing is about finding niches—services your firm can provide that few others can. It means developing skills and determining which services are commonplace and will be billed at your hourly rate, and which areas will allow you to be creative and come up with ideas to benefit the client. Ideas that would not have materialized had you not been involved are worth more than your hourly rate.

One of the things partners sometimes lose sight of is that CPAs are in business. They don't think of themselves as business people. If the client is satisfied, you don't have to cut the bill.

In most instances, clients are willing to pay the fee you set and you can bill higher than average. You have to let clients know that your services are above average, though, and that neither they nor your "competition" is going to set your fees.

Don't be one of those CPAs who bills mechanically. Remember, billing is an attitude, not a process. ☑

—by Sidney F. Jarrow, CPA
Chicago, Illinois

CHANGES DUE IN BILLING AND COLLECTION HABITS

July 1990

When there are major changes in any industry or profession, some areas will adapt much more quickly than others. In recent years, the accounting profession has undergone significant changes in its code of ethics, in the use of technology, and in the needs and wants of clients. It has also been affected by shifts in the general economy. As a result, many aspects of public practice have been altered.

An underlying implication of almost all the changes has been the impact on the economic structure of CPA firms. The cost of CPE has increased significantly, total personnel costs have risen dramatically, and the cost of professional liability insurance, once a nominal factor, is now a major line item in the budget. In addition, competition has intensified.

One aspect of public accounting that has been slow to change, however, is the billing habits of CPAs. During the 1940s and 1950s, CPAs embraced time-based billing. What became, basically, a cost-plus approach was no doubt appropriate in the professional environment of the time. Professional services provided then were mainly auditing by the larger firms and general accounting (actually bookkeeping) by the smaller firms. The compliance aspect of tax work dominated the balance of most firms' product lines.

The last twenty years has seen a significant expansion in the number and variety of services offered by CPA firms—new services which sometimes meant new sources of competition from outside the profession. Banks, management consultants, computer firms of every type, and other providers of these services are basically market driven. They are inclined to see price as what someone will pay for the service, or as what the service is worth on the market. CPAs, though, are still obsessed with billing rates and, for the most part, accept only a portion of the standard rates they carefully calculate based on a portion of their payroll costs.

Most billing rates are calculated on direct payroll and tend to ignore the many additional costs of personnel. Depending upon how broad your definition is, costs in addition to the paycheck include taxes, benefits of all kinds and, perhaps, CPE. These costs in a typical firm probably run from twenty percent to fifty percent of bare payroll numbers.

As the changes in our profession continue and their impact becomes more pronounced, the old cost-based billing system will ultimately break down. When the current billing formulas and bad habits of billing late and collecting even later were formed and cast in stone in the 1950s, interest rates were two percent—a far cry from the cost of money today. Practitioners will not be able to survive the 1990s, to say nothing of prospering, if they fail to recognize the need for significant changes in their billing habits.

In the 1990s, practitioners will need to recognize that one size no longer fits all. Accounting and tax services have not only become quite different, the subactivities conducted within these disciplines have also become more complex. In addition, the activities now practiced under the broad umbrella called MAS encompass a wide array of services that have different values to clients and demand substantially different resources to provide. Time is no longer an accurate measurement of these activities.

In the decade ahead, CPAs who choose to be successful will find new ways of billing clients. Today, value billing, while often talked about, is seldom practiced. Even when it is, the results are more often a windfall than a planned, structured activity. The use of menu billing will grow, and other techniques will be developed to effectively gauge the value of the service to the client, the cost to the CPA firm, and the acceptable price in the marketplace.

At some point, CPAs will accept that billing is no longer a cost-accounting exercise conducted as an administrative task. It will be accepted as, perhaps, the firm's most important marketing decision. ☑

—*by* **Charles B. Larson, CPA,** *3300 Dale Avenue, St. Joseph, Missouri 64506, tel. (816) 279-7493*

Evolution in Billing Systems

The systems that underlie the billing process have also undergone some evolution, but there is still a long way to go.

Initially, the time accumulation process was entirely manual. This was time-consuming, expensive, and delayed the billing process. One-write systems speeded up and made the process more efficient, but still left much to be desired.

Even the best time systems miss much of the crucial ingredient—time. As a result, much of the work performed for clients is unbilled.

Beginning in the 1960s, computer systems improved the accuracy of the process and somewhat shortened the time from work to collected fee. The process still missed far too much of the driving ingredient, however, and was still slow and cumbersome.

At first, time sheets were prepared monthly. This resulted in long delays in the billing process with clients not receiving bills until sixty to ninety days after the work was performed. They usually paid ten to forty days after receiving their bill. These astonishing delays were encountered in what were considered good circumstances. More often the periods were longer.

Statistics generated in many surveys suggest that practitioners are comfortable with forty-five days of their gross billing tied up in work-in-process and another forty-five days in accounts receivable. A firm with fully fifty percent of its annual billing tied up in uncollected fees is not uncommon, when the truth is known.

Firms began going to biweekly and weekly time sheets in the 1970s and 1980s. This was some improvement but not much. In the past couple of years, there has been some movement to daily time sheets. But again, this is only a Band-Aid on a significant wound.

The 1990s will see firms adopting more advanced techniques to instantly capture all data needed for billing. Bills will go out with delivery of the product.

Section 7

CHARGEABILITY AND PRODUCTIVITY

INCREASING STAFF CHARGEABILITY

October 1985

I was surprised, several years ago, to find out that the staff of our eight-person firm had no idea of the number of chargeable hours expected of each individual. Producing an adequate number of chargeable hours for each staff member is an ongoing challenge in most CPA firms, and the topic is discussed frequently at management of an accounting practice (MAP) conferences because of its direct effect on firm profitability.

I have attended five national MAP conferences and several state society ones. The following are some of the ideas gleaned at these conferences which we have implemented and which have helped us to significantly increase our staff productivity. We

- ☐ Establish a yearly budget for each employee, stating the number of chargeable hours expected, and discuss the budget with each individual. (We also budget productive nonchargeable hours such as firm management, billings, public relations and CPE.) The budgets should be reasonable (challenging but attainable)—it is amazing how performance rises to the level of expectation.
- ☐ Break down the annual budgets by month and then into semimonthly periods (which coincide with time-reporting periods). These monthly budgets are based on seasonal patterns and are heavily skewed toward busy season.
- ☐ Post chargeable hours daily to a semimonthly production report. (We keep ours on the office bulletin board.) Employees who are out of the office call in this information daily to the receptionist. The percentage of budget for the period and year to date are computed for each employee and for the total firm.

  The daily totals are reviewed by the scheduling executive to pinpoint any problems before they get out of control. Monthly chargeability and a breakdown of nonchargeable time by individual is maintained on a microcomputer.

To summarize, we have significantly increased individual staff chargeability by establishing goals for each employee, communicating these goals to the employees, closely monitoring actual results, and by taking corrective action where necessary. We find that this results in employees being more aggressive in seeking chargeable work, in a more profitable firm, and in better control over operations. ☑

—by Wallace B. Collins, CPA
Jackson, Mississippi

MONTH April, 1985

STAFF MEMBER	CURRENT MONTH ACTUAL HOURS	CURRENT MONTH BUDGET HOURS	CURRENT MONTH OVER (UNDER) BUDGET	YEAR TO DATE ACTUAL HOURS	YEAR TO DATE BUDGET HOURS	YEAR TO DATE OVER (UNDER) BUDGET	1984 YTD ACTUAL
BROWN	150	135	15	638	657	(19)	631¾
DOE	173¼	158	15¼	750½	765	(14½)	578
GREEN	109¾	117	(7¼)	572¾	569	3¾	459¾
JOHNSON	99¼	122	(22¾)	533	591	(58)	558¼
ROE	115¾	94	21¾	431½	455	(23½)	290
ROGERS	118½	124	(5½)	557½	600	(42½)	392½
SMITH	187¼	168	19¼	813¾	810	3¾	—
WEBSTER	177½	168	9½	789¾	810	(20¼)	—
WHITE	180¼	168	12¼	813¼	810	3¼	—
COMPUTER	39	36	3	136¼	175	(38¾)	125¼
OTHER	33	22	11	99¾	108	(8¼)	1857½
TOTALS	1383½	1312	71½	6136	6350	(214)	4893

LETTER TO THE EDITOR (INCREASING STAFF CHARGEABILITY)

January 1986

I enjoyed the article on increasing staff chargeability that appeared in the October issue. It is certainly an area of concern for every firm, and the ideas communicated in the article are interesting.

We have found over the years, though, that tracking chargeable hours and budgeting total chargeable hours by individual is not enough. It is important, in addition, to relate billable hours to realization by person. We have therefore designed a monthly production report that shows the dollars billed by individuals and the total potential billable dollars (see the example below). This is easily done, as our time and management software produces all of the required information, which the report merely summarizes.

By doing this monthly, we focus on another crucial problem in smaller firms, namely cash flow. There is a built-in incentive for staff members to complete jobs so that these may be billed, thus keeping up their billable and chargeable percentages.

We believe this is an effective system. I have attended several management of an accounting practice conferences and have noted, when comparing statistics with other participants, that our percentages are comparatively high. ☑

—William J. Walsh, CPA
Rochester, New York

WALSH & COMPANY

PRODUCTION
October 31, 1985

	Ken	Mike	Vince	Pam	Jim
MONTH					
Total hours	158	160	160	166	160
Chargeable hours	119	160	146	125	154
% Chargeable	75%	100%	91%	75%	96%
Potential dollars	$6,572	$ 8,800	$6,570	$5,602	$6,930
Dollars billed	$7,626	$10,949	$3,839	$5,111	$6,887
% Billed	116%	124%	58%	91%	99%
YEAR TO DATE					
Total hours	534	536	536	508	495
Chargeable hours	394	446	486	310	408
% Chargeable	74%	83%	91%	61%	82%
Potential dollars	$24,686	$24,745	$22,846	$13,972	$17,363
Dollars billed	$20,591	$23,106	$18,832	$ 9,256	$16,480
% Billed	83%	93%	82%	66%	95%

CONTROLLING NONCHARGEABLE TIME

May 1984

In order to better control the nonchargeable time of professional staff, I have developed a system that utilized our IBM PC and an integrated spreadsheet program, Lotus 1-2-3. I think the system has merit in a local firm because it controls the nonchargeable time by 9:00 A.M. each work day.

We request all staff members to hand in a form by the first thing every morning that shows their estimated chargeable, nonchargeable and total hours for that day, and the actual number of hours in each of the three categories for the previous day. A time report is generated by the computer from this data which shows the accumulated time and the actual time for the previous day, plus a recap of all time for the week and month to date (see exhibit on page 7). This permits a daily analysis of the projected chargeable time for the month, once the average billing rate is determined.

By having this report on my desk by 9:00 A.M., I only lose one hour of nonchargeable time that I

Daily Worksheet—Mork & Co. Ltd.

Date *3-30-84*

Name	*Monday*		*Tuesday*		*Wednesday*		*Thursday*		*Friday*	
Daily data	*Est.*	*Act.*	*Est.*	*Act.*	*Est.*	*Act.*	*Est.*	*Act.*	*Est.*	*Act.*
ABC										
Chargeable	4.0	4.3	4.5	4.0	5.0	6.5	5.0	5.0	3.0	3.0
Nonchargeable	4.0	4.0	3.5	4.0	3.0	4.0	3.0	3.0	5.0	1.0
Total hours	8.0	8.3	8.0	8.0	8.0	10.5	8.0	8.0	8.0	4.0
DEF										
Chargeable	4.0	4.0	4.0	3.0	4.0	5.0	5.0	5.0	5.0	6.1
Nonchargeable	4.0	4.0	4.0	4.0	5.0	4.0	3.0	3.0	3.0	3.8
Total hours	8.0	8.0	8.0	7.0	9.0	9.0	8.0	8.0	8.0	9.9
Daily staff										
Chargeable	20.0	20.8	20.5	17.0	19.0	21.5	16.0	17.0	19.0	18.8
Nonchargeable	16.0	19.5	19.5	21.0	23.0	22.0	23.0	23.0	20.0	17.6
Total staff hours	36.0	40.3	40.0	38.0	42.0	43.5	39.0	40.0	39.0	36.4
Chargeable part	0.6	0.5	0.5	0.4	0.5	0.5	0.4	0.4	0.5	0.5
Weekly chargeable		429.5		446.5		468.0		485.0		503.8
Weekly nonchargeable		356.4		377.4		399.4		422.4		440.0
Weekly total hours		785.9		823.9		867.4		907.4		943.8
Chargeable part to date		0.5		0.5		0.5		0.5		0.5
Chargeable	408.70									
Prior weeks Nonchargeable	336.90									
Total	745.60									
Office										
Chargeable	2.0	4.5	3.0	3.0	3.0	3.0	3.0	2.0	2.0	3.0
Nonchargeable	14.0	11.5	13.0	13.0	13.0	13.0	13.0	14.0	14.0	19.0
Total hours	16.0	16.0	16.0	16.0	16.0	16.0	16.0	16.0	16.0	22.0
Chargeable part	0.13	0.28	0.19	0.19	0.19	0.19	0.19	0.13	0.13	0.14
Weekly chargeable		55.75		58.75		61.75		63.75		66.75
Weekly nonchargeable		290.25		303.25		316.25		330.25		349.25
Total hours to date		346.00		362.00		378.00		394.00		416.00
Chargeable part to date		0.16		0.16		0.16		0.16		0.16
Prior week chargeable	51.25									
Prior week Nonchargeable	278.75									
Prior week Total hours	330.00									

cannot sell. Accounting for time this way seems to be a better process than end of month questioning as to why nonchargeable time is so high. Since requesting staff to complete this form, our chargeable time has increased 20 percent.

Basically, we are using the same type of method that a manufacturing company would use. We can't sell time that is already past. We can only sell time that is available in the future. The system allows us to assign the most suitable person with the greatest amount of nonchargeable time to a job. The supervisor of our accounting staff and the tax supervisor also receive copies of the report. In the event of unforseen developments, they can then readily identify people with nonchargeable time.

It only takes about three minutes for staff members to fill in the form at the end of each day, and about another five minutes for the secretary to generate the report on the computer. Time and cost are thus minimal but the benefits are substantial.

—by David S. Mork, CPA
Saint Paul, Minnesota

THE IMPACT OF GROWTH ON UTILIZATION

August 1979

Public accounting sages claim that a firm must grow or else it will die. While this is not really an accurate capsular commentary, it is true that most firms in our profession lean toward growth as a policy. This way they can encourage younger partners and staff people by providing them with personal growth opportunities.

Most of us are familiar with the necessity to allow sufficient lead time in our firms' planning cycles to accommodate the many changes that will result from growth. Recruiting and training staff, office space and equipment needs, billings and collections, capital requirements and partner and staff compensation are all subject to changes.

Not so familiar are the structural changes in manpower chargeability that buffets firms as they grow. These changes in time utilization must be anticipated and monitored if the transitions in partners' and staff's scheduling are to be smooth.

An analysis of the three exhibits in this article reveals marked shifts in utilization (average chargeable percentage) of personnel, particularly partners. These shifts coincide with the organizational phase represented by each exhibit.

The exhibits consist of rounded averages of chargeability for each professional level in a CPA firm from a sample of 37 firms. These 37 firms, in turn, represent the fastest growing 20 percent of a larger sample of 185 local practice units located throughout the country. No firms in either category had more than 75 partners and staff.

Exhibit 1 represents firms in phase 1 of their growth patterns. This phase is that of the partner/entrepreneur who deals directly with the clients, and the emphasis is on creating the product and developing the market. Communication within the firm is very informal and frequent, and control of activity stems from direct and immediate client feedback. Partners and staff alike work long hours, and partners have as much (or more) average utilization as the staff. And often there are more partners in the firm than staff people.

The firms represented in exhibit 2 are in the second phase of their growth and development patterns. Clients are larger now, and more employees have come on board. Feedback from clients to partners is less frequent and direct, and budgets have been developed for time and money allocations. The firm becomes departmentalized (in fact or de facto), partners and staff people develop specialties and more time is devoted at the partner and higher staff (manager) levels to administrative and managerial activities.

Average utilization for partners typically decreases in phase 2 while that for lower level staff increases to carry the brunt of the work load. Partners in the fastest growing firms usually made this adjustment easily. However, in the remainder of the 185 firms, the adjustment was not made as well, and the average partner utilization remained in the 80 percent range. One can see a parallel between partners' willingness and ability to adapt and their firms' growth rates.

Firms in phase 3 (the age of delegation) are represented in exhibit 3. In this phase, more responsibility is given to the staff with managers taking on most of the administrative duties. Note that the supervising in-charge level has the greatest average utilization (along with paraprofessionals). Profit centers are developed in the firm, and partners' average utilization diminishes markedly as they concentrate on planning, communication , expansion and, often, acquisition.

Reduced chargeability at the top is symptomatic of rapid growth—when the partners are capable of using the released time to develop new business, recruit and train new employees, and plan for shifting utilization targets among the staff.

Conversely, rapidly growing firms maintain very high utilization percentages for staff personnel at all levels including support and clerical staff. Coupled with this rapid growth, there must be planned programs of staff involvement to prevent a deterioration of morale as production pressures

Exhibit 1

Typical Utilization
Firm with 3 Partners, 7 Staff Members

Classifications	*Average annual total hours*	*Average annual chargeable hours*	*Average chargeable percentage*
Partners	2,800	2,300	82
Professional staff	2,400	2,000	83
Support and clerical staff	2,200	1,250	57

Exhibit 2

Typical Utilization
Firm with 7 Partners, 25 Staff Members

Classifications	*Average annual total hours*	*Average annual chargeable hours*	*Average chargeable percentage*
Partners	2,600	1,900	73
Managers	2,400	1,950	81
Professional staff	2,300	1,950	85
Paraprofessionals	2,100	1,950	93
Support and clerical staff	2,100	1,150	54

Exhibit 3

Typical Utilization
Firm with 50-60 Total People

Classifications	*Average annual total hours*	*Average annual chargeable hours*	*Average chargeable percentage*
Partners	2,500	1,400	55
Managers	2,400	1,800	75
Supervisors	2,300	2,100	91
In-charge accountants	2,300	1,950	85
Staff	2,300	1,850	80
Paraprofessionals	2,200	2,000	91
Support and clerical staff	2,100	1,050	50

mount unabated. Turnover was light in the 37 fastest growing firms in the sample during phases 1 and 2 but increased noticeably when they were well into phase 3. The golden sheen of opportunity tends to tarnish after long periods of maximum effort, except in those firms where the partners involve managers and in-charge level staff members in a management team that collectively addresses the problems of and adjustments to the changing requirements of growth.

In summary, it is apparent that better than average growth of a practice through phase 2 and into phase 3 necessitates that the partners and higher level staff shift more time and effort toward becoming business managers and spend less time practicing as professionals. Before any firm sets its course for growth, the partners should ask themselves if they are ready and able to personally accommodate the changes necessary in their management styles.

–by Donald F. Istvan, CPA
D. F. Istvan Associates, Inc.
Barrington, Illinois

GROWTH AND UTILIZATION REVISITED

January 1980

In the August 1979 issue of the *Practicing CPA*, the article titled "The Effects of Growth on Utilization" by Donald F. Istvan, CPA, of Barrington, Illinois, stimulated considerable interest.

Among the many responses were about a half-dozen from practitioners who expressed concern over the relatively high chargeable times shown for partners in the firms included in exhibits 1 and 2 of the article. The following clarifications provided by Mr. Istvan should answer most of their queries:

- ☐ The sample of firms reported upon, while very real in terms of hard data, may not in fact be representative. For instance, those firms making up the basis for exhibit 1 are less than one-third of the total firms in the sample. In fact, only seven firms comprise the fastest growing 20 percent of that category. Of the seven, two have four partners, and three are sole practitioners with staffs. Thus, the figures must include some distortion from the rounding into "typical" categories.

- ☐ The measurement of growth used to determine the fastest growing 20 percent in each category was chargeable hours for the firm as a whole. It is possible that some firms provided information on chargeable hours which, in fact, are distinguished from billable hours. The sample, therefore, may have provided distortion by including hours that weren't billed to clients.

- ☐ It is very likely that some partners may record chargeable hours beyond those actually worked. Such padding is often found in firms where billing rate standards are set too low for current market conditions.

- ☐ The data are current in that they were collected over the past five years. Thus, there is no way to know if the fastest growing firms from exhibit 1 will grow to become the fastest growing firms by the time they would fit into exhibit 3. There is a real possibility that they wouldn't because of partner exhaustion, particularly if the recorded hours are in no way padded to make up for low billing rates.

  Similarly, these firms might not continue to grow as fast because the partners are unable to properly administer and manage the practice. Such a shift from doing technical work to managing is the thrust of the previous article.

- ☐ Some of the firms representing the fastest growing 20 percent in exhibits 1 and 2 achieved that status at the expense of profitability per chargeable hour. This stems from the fact that their standard billing rates are low, even for their own geographical marketplace.

  For example, among the seven firms represented in exhibit 1, the highest partner billing rate is only $45 (translated into 1979 rates). Forty dollars is the rate in two others. The rest are lower. One sole practitioner with a recorded 2,475 chargeable hours is billing himself at $32 per hour and his staff at $14 to $15 per hour. Thus, it appears that current growth in chargeable hours is coming at the expense of optimizing the hours/rate mix. In the long run, this might serve to remove the firm from the fastest growing 20 percent category for much the same reasons as indicated above.

MAINTAINING PRODUCTIVITY ON A FIRMWIDE BASIS

January 1986

What Abraham Lincoln reputedly said about lawyers is just as applicable to accountants: "Our stock in trade is our time." To extend that thought further, the way we manage the chargeability of our time and that of our staff determines in large measure how well we are rewarded for our efforts.

In public accounting, chargeability must be firmwide. Productivity cannot be successfully delegated to one or two people. Each person must assume responsibility and be accountable for the chargeability of his or her time. In order to pay more than lip service to this concept, there must be a system within the firm to provide staff with a clear understanding of what is expected and also with a way to measure these goals.

In our practice, the administrative partner determines what the chargeability rates should be for each level of staff accountant in the firm. We then ask all accountants to complete their own monthly budgets accordingly. This allows them to take personal schedules, such as holidays and vacations, into consideration while also giving them a way to measure their own chargeability on a month-to-month basis.

Thereafter, on a semimonthly basis, staff members are provided with reports comparing their budgeted hours to actual, both for the current period and year-to-date. Each staff person is evaluated on a quarterly basis, and this evaluation includes a review of chargeability and performance.

The program is successful. We have been able to measure about a 6 percent increase in average chargeability among our professional staff over a one-year period. Moreover, I think it has brought into much clearer focus the expectations we have with respect to staff's chargeable performance. ☑

—by John G. Hodgson, Jr., CPA, CFP
New Bedford, Massachusetts

MEASURING OFFICE PRODUCTIVITY TO INCREASE PROFITABILITY

January 1984

The main reasons for measuring productivity are to evaluate the efficiency of current practices and systems and to identify opportunities for improving performance. This is achieved by selecting the best ways to perform office functions to meet the organization's goals and by establishing achievable and measurable work standards that motivate staff members to improve output.

Many firms believe they cannot measure staff members' efficiency because they lack the data with which to gauge productivity and assess employee work attitudes. Consequently, many office tasks are deemed unmeasurable and key decisions concerning efficiency and cost-effectiveness of operations are made without specific, quantified information.

Although assessing productivity and employee attitudes is difficult in a nonmanufacturing environment, a great deal of technical expertise is no longer required. Several new techniques make the job relatively straightforward.

Before productivity can be measured, it is often necessary to break each task down into its component activities and estimate the amount of time needed to complete each one. In an office, work can often be done in any number of ways, and it is impractical to develop a precise time for each component activity. Consequently, administrators have used subjective judgment to manage office work and evaluate employee productivity. However, managers may now choose from three objective methods of productivity measurement. These are: simplified predetermined time standards systems, self-logging and work sampling.

The first of the three methods is the most accurate, but until recently, it required a level of technical expertise unavailable in most offices. Now there are several systems available, such as MODAPTS (modular arrangement of predetermined time standards), developed in Australia, which are relatively simple for nontechnical people to learn and use.

Most traditional work measurement approaches cannot assess tasks that require thinking as opposed to those activities that are purely physical. The second method—self-logging—can be used to assess the many, sometimes discrete, tasks performed by office workers. The data are gathered from employees who keep simple daily time records for a short study period. They record how much time they spend on specific activities and indicate the volume of work completed during the day. Work standards are developed from this data.

The computer has eliminated most of the drudgery associated with self-logging—the sorting, tabulating and manipulation of data—and has made this technique economically attractive to even small firms that wish to develop accurate work standards. But for those firms willing to sacrifice some degree of detail and accuracy, work sampling is an easier and less costly method.

Based on the laws of probability, work sampling relies on the random observation of employees to determine the relationship between major categories of activities such as working time versus idle time. One observer, who need not be a highly trained work-measurement analyst following a rigid timetable, can simultaneously observe several employees. Computer aids are available to assist in calculating the minimum number of observations needed to achieve a given degree of accuracy and in tabulating the study results.

Attitude surveys are often the best way to determine employees' perceptions and feelings about their jobs and working environment. Such surveys can help identify problems and their underlying causes and provide a standard for future comparison. More specifically, they can be used to

☐ Obtain before/after measurement of results.
☐ Identify training needs.
☐ Appraise perceived leadership qualities.
☐ Evaluate company policies.
☐ Assess supervisor/staff relationships.
☐ Promote staff involvement in and support for company programs and objectives.

In an employee attitude survey, the number and structure of questions to be asked are crucial variables. These must be precisely defined in order to elicit objective answers about such issues as job satisfaction, internal motivation and job performance.

It is essential that the survey is properly structured to address specific and relevant issues and that the results are published and put to use. If nothing is done, the experience is frustrating for all concerned. However, if the information is used to improve conditions, staff morale and productivity will improve too. Office workers have lagged behind workers in manufacturing operations in efforts to measure productivity. Nevertheless, today's technology makes it possible to measure what used to be considered unmeasurable—and to size up a firm's chances of increased productivity and profitability.

–by Victor F. Albanese and Kathryn J. Wolf
New York, New York

Editors note: Mr. Albanese is a specialist in work measurement, productivity improvement and employee motivational programs, and Ms. Wolf specializes in higher education and other institutions for Peat Marwick Mitchell & Co.

SHRINKING THE "BLACK HOLE" THAT WORK FALLS INTO

November 1989

The problem we faced was to manage the flow of work through our office more efficiently to permit quicker turnaround. The specifics of the situation were as follows.

Work is picked up from clients and brought to our office. This normally occurred without the information first being reviewed to see that it was complete and correct. Frequently, the client contact also neglected to note unusual events that occurred during the year, and to set a budget, a due date, and a clear objective.

At any given time, there were probably five or six jobs on each staff accountant's schedule, making it difficult to monitor each one for budget and due date. In addition, staff members found it difficult to set priorities because a different person may have been in charge of each engagement and all would be pressing them for completion of the work.

Consequently, staff members tended to work on what they perceived to be the "hottest" project until they needed information or needed to have a question answered. They tended not to spend time seeking information, though, because they always had several other "urgent" jobs to work on. The net result was that projects were put aside, and instead of a smooth flow of work through the review process, there was a flood of several jobs at the same time, creating a bottleneck or, worse, a "black hole" into which the work disappeared.

In reviewing this situation, we made the assumptions that a staff member can only work on one job at a time, that work time increases proportionally as the number of times a project is picked up and set down increases, and that it is the responsibility of the person who has contact with the client to assure that work is complete and correct when it is brought into our office.

Our solution to the problem

We decided that all work received in our office would first be sent to a coordinator so that projects could be properly planned. This would include all work to be delegated to a staff member, no matter whether it was brought in by a partner, a manager, or another member of the staff.

The planning process we established includes budgeting time, determining a due date, reviewing the information, notifying the client if additional items are needed, listing unusual items that may not be readily apparent to the staff accountant assigned to the job, determining the engagement objective (level of service, amount of disclosure, and whether it is comparative or not), and detailing the approach that should be taken. No work would be released to staff until the planning process had been completed.

To keep the time delay to a minimum, we made it mandatory that the accountant in charge makes sure all the necessary data is brought to our office. Each job would then remain in a backlog until a member of the staff was ready to begin work on it. In addition, staff accountants would have only one primary job on their schedules, which they would work on until it was ready for checking. At that time, another job would be released to them.

We saw a number of advantages to this process. First, because each staff member would have only one project to concentrate on at a time, there would be no confusion over priorities. That decision would be made by the release of the work to staff.

A second advantage that we saw was in the area of control. Staff members would have only one client file in their offices at a time, and we thought that control of each job would be enhanced because there would be only one job per person to monitor. We believed this would help us determine and smooth out workloads, too, and avoid having to switch assignments after already explaining the work in detail to someone else.

How our solution has worked

A smooth flow of work to the reviewer and approver allows them to better plan and execute those functions. In addition, the process resulted in a clearer idea of which jobs would be sent for checking and approval in a given week, and the approximate day on which they could be expected.

With each staff member having only one job to concentrate on with fewer interruptions, we have realized significant improvements in both quality and timeliness. And, just as important, staff has gained a sense of accomplishment on a regular basis by being able to finish a task on time.

We decided that an audit would be planned similarly to any other engagement. Because the work is usually performed at the client's place of business, however, we decided to do it in phases, and have each phase placed in a backlog for assignment to staff. During the time that staff accountants are assigned to a particular phase of an audit, it is the only job on which they work. In addition, we have the audit staff perform some of the less time-consuming tasks when scheduled to be in our office.

On occasion, we need additional information in order to complete an engagement. This can most often be taken care of with a telephone call to the client, confirmed by memorandum.

In situations where the client needs time to supply the information, the job reverts to an unassigned status and the staff person is given other work. It is then the coordinator's responsibility to follow up with the client to get the information.

Once this is received and found to be adequate to finish the job, the work is reassigned to the original staff member when he or she is available. The emphasis at our weekly scheduling meeting is, therefore, to determine which jobs will be completed that week and which will be released to staff.

One pitfall we encountered was that associates who had tended to believe they owned a particular job suddenly found someone else working on *their* accounts. With their sense of ownership diminished and not feeling the pressure of the backlog of work sitting in the coordinator's office, they did not have the commitment to the overtime hours that are necessary in tax season. As a result, we modified the system last tax season, to increase the workload, then changed it back again afterward.

There are numerous advantages to this method of controlling the workflow. We had always imagined we gained efficiency by having people perform the same jobs over a long period of time. When we moved work around under the new system, however, we found that not only the timeliness of service to clients generally improved, but the number of hours needed to complete the engagement was often reduced.

In addition, staff has become more creative and more thorough. Different people tend to look at the same job differently, resulting in new thinking and new ideas. And knowing they might not see the job again, they leave a clearer trail for those who follow.

The concepts for this procedure came out of my introduction to a book, *The Goal—A Process of Ongoing Improvement*, by Eli Goldratt,* which discusses ways of finding solutions to problems rather than continually fighting fires. Not only have we put the ideas to use in our practice, but we give the book to, and have started consulting with, manufacturing clients on the basic concepts. All in all, the process has forced the changes we wanted, and we are convinced it is the way to go. ☑

—by **Ronald C. Russell, CPA,** *Mesarvey Russell & Co., 1905 West North Street, Springfield, Ohio 45504*

**Editor's note:* The Goal—A Process of Ongoing Improvement *(Croton-on-Hudson: North River Press, 1986) is available for $15 a copy ($9 each for a case of 40 copies) from Common Sense Manufacturing, Inc., P.O. Box 3894, Suite 288, Milford, Connecticut 06460, tel. (203) 877-9253.*

OPERATIONS CONTROL FOREMANSHIP

October 1978

The greater the number of people involved in an engagement, the more critical it is to have a good system for monitoring the flow of work.

The following system, which has worked well for practice units ranging in size from those with a few people to firms with dozens of employees, consists of work control sheets, status control sheets and a three-ring binder (the status control book). The control sheets are preprinted on 8½" x 11" colored paper and punched for insertion in the three-ring binder. Suggested color codings (light shades) are as follows:

- ☐ Work control sheets for individual tax return clients—blue.
- ☐ Status control sheets for individual tax return clients—yellow.
- ☐ Work control sheets for all other engagements—salmon.
- ☐ Status control sheets for all other engagements—green.

The headings on both control sheets are identical, that on the status control sheet being a carbon copy of the heading on the work control sheet. Each step in the engagement (including clerical), from preparing workpapers to mailing or delivering the finished item, is listed on the left-hand side of the work control sheet. The column headings across the top are for the components of the engagement, such as reports, and federal and state tax returns. The status control sheets have column headings for the date and for remarks.

The control sheets should be headed up in advance and filed alphabetically by clients' fiscal year-end. When an engagement is activated, the work control sheet should be given to the in-charge accountant and the status control sheet filed in the status control book, which is divided into sections, one for each in-charge accountant. The work control sheet should stay with the workpapers every step of the way and no operation performed without it.

At the beginning of each week during an engagement, the in-charge accountant should record the date and status of the job on the status control

STATUS CONTROL SHEET

CLIENT ______________________ PERIOD ENDING ______________
ADDRESS ______________________ EXTENSION FILED TO ______________
______________________ PARTNER ______________
______________________ IN CHARGE ______________

DATE	STATUS

______________ COMPLETED—TRANSFERRED TO INACTIVE FILE

Rev. 11/74

WORK CONTROL SHEET

CLIENT ____________________ PERIOD ENDING ____________

ADDRESS ____________________ EXTENSION FILED TO ____________

____________________ PARTNER ____________

____________________ IN CHARGE ____________

								State Returns					
	Workpapers	Preliminary Report	Report	Federal Extension	State Extension	Federal Return	Federal Estimate	Income Tax	Estimate	Franchise	Management Letter		
Prepared by													
Partner review													
Points cleared													
Referenced													
Reference points cleared													
Final partner review													
Tax dep't review													
Tax points cleared													
Typed or photocopied													
Compared and proved													
Partner approval													
Signed													
Mailed/delivered													
Date promised													
Number of copies													

Special instructions:

Staff evaluations ________________

Next year's staffing ________________

Journal entries ________________

sheet. Upon completion of every step in the engagement, an administrative person (who has been assigned to this function) should review the control sheet for completeness and then file it as the first page of the completed workpapers.

The status control sheet should then be removed from the book, initialed and dated at the bottom of the page and filed alphabetically by client's fiscal year-end. The control sheets for the next year's engagement can be prepared from these completed status control sheets at a convenient time.

Locating a particular client's file during the individual income tax filing season, when several preparers are involved, may be facilitated by the use of an alphabetical log (clients' names) of preparers' assignments that is activated by date.

But the two important principles to remember are that no one should perform any work on an engagement without a work control sheet and that no engagement should be considered complete until each item in each column of the work control sheet is initialed and dated, and the status control sheet is removed from the book.

–by Norman C. Batchelder, CPA
Keene, N.H.

A slight variation on the above method is offered by Paul Browner, CPA of Silver Spring, Md.

First of all, and depending on the volume of work, Mr. Browner suggests using a copy of the work control sheet as the status control sheet. Then, at the beginning of each week, the in-charge accountant could run the work control sheet, with whatever entries are on it, through a copying machine and put the copy in the status control book. That would kill the color scheme—the copy being white—but Mr. Browner thinks it may not be too important because the status control book would be in alphabetical order anyway. A grid would have to be added to the sheet to show the latest date and the in-charge accountant's initials.

The "Date promised" listing down the left side of the work control sheet gave Mr. Browner another idea.

He suggests adding some space to show the estimated days to do a job, the actual time it took, and whether actual time was over or under estimated time. He also thinks that it might be valid for the administrator who closes out the control sheets to tally up these figures and let them be known to the managing partner.

Other suggestions for controlling work in process can be found in chapter 205 of the MAP Handbook.

IMPROVING PRODUCTIVITY

January 1983

What is productivity in a practice and why is it important? It certainly does not mean running a sweatshop. Staff people don't want to work an exorbitant number of chargeable hours in order to make partner. They are demotivated by that prospect. Rather, a productive practice is one that is both efficient and effective.

Achieving a high level of productivity through efficiency and effectiveness is a worthwhile endeavor because of the important benefits that result. In most cases however, responsibility for firm and individual productivity needs to be defined—somebody must be made responsible for it.

Productivity improvement at the firm level can be a motivator because people take pride in being part of an efficient, effective group. Potentially, big productivity gains are possible here. In many firms, work that should be done by lower-level staff members is done by supervisors, managers—even partners. Work should always be done by the lowest-level staff person who can satisfactorily perform it. Don't have a $50 per hour person working on a $25 per hour job.

Analyze firm-level productivity by service area and client groups to see which are the most productive. Compare your offices, too, if yours is a multi-office operation. The immediate effect of a new office on productivity is nearly always negative. Based on statistics at one recent MAP conference, the average per partner profitability of two-office firms is about $14,000 less than for one-office firms, and there can be a $34,000 difference when you get to four-office firms. In all areas of the firm, you will have to find a balance between needed investment (for the future) and making a profit.

Now, what about productivity improvement at the individual level? To achieve this, you must have the right sort of people on the staff to begin with. You have to be able to see more than just a graduate when hiring someone. You need staff members who have drive, high energy levels and an interest in advancement and growth. People will make the effort if they see it will lead to something they want.

An environment that provides for staff's expectations is essential. Good things should happen when staff perform well. Partners must set good examples and staff members must receive feedback. They want to hear about the negatives as well as the positives because they know they are not perfect.

The firm should provide opportunities and incentives for achievement. Monetary rewards are an obvious incentive but other forms of recognition are important too. A few words of acknowledgement or approval can be a tremendous morale booster as can holding up outstanding performers or performances as examples. You can't give too much recognition.

Providing interesting work can also aid productivity. This can be done through specialization which often has the double advantage of being both a motivating factor for staff members and providing additional profits for the firm. The work must be at the right level, though, and it is important to staff people that they see advancement and are given increased responsibility year by year. In many cases, people can handle more than they are given.

Obviously, any improvements in productivity will necessitate the supervision and training of staff and the removal of productivity barriers. People's productivity declines if conflicting demands are made of them or if work is badly distributed so that some are not busy while others are overworked.

Inefficient work spaces are another handicap. Individuals need sufficient work and filing space if their work areas are not to look messy and they are not to spend a lot of time searching for something on their desks. Visual distractions, such as a busy hallway just outside an office, should be avoided and noise levels should be kept as low as possible. Shared offices are a bad idea in this respect, as are low cubicle walls and loud staff radios. A few rules about long, loud conversations and the use of individual radios might be a good idea, and you might find that office landscaping can muffle much of the sound.

Don't forget the office layout when thinking about improving productivity in your firm. Office machines, supplies, reference materials and other needed equipment should be readily accessible; and walking distances can be reduced if partners' offices are scattered, rather than all in one place. If 20 people, whose average billing rate is $40 an hour, save five minutes a day, the result can be an extra $16,000 net at year's end.

Above all, the right atmosphere must be created by the partners. A mood of grim determination, with everyone out for themselves, is not what is needed. And getting staff people to make an extra effort and then not telling them why their work was not used is detrimental. Anything that causes guilt, anger or worry is an emotional productivity drain.

You can conduct a productivity audit of your firm in the following way:

- ☐ Pick 5 to 10 areas from the article that you believe offer the greatest payoff from improvements.
- ☐ Gather enough data to tell you which specific improvements would work. Include staff input. Let staff members know what you are doing. You will get lots of good ideas from them.
- ☐ Evaluate improvements for cost and benefits. Put them in order of priority.
- ☐ Implement improvements one (or just a few) at a time. Keep everyone informed on what you plan to do, why and when. Solicit suggestions.
- ☐ Measure and evaluate results. Again, keep people informed.

Productivity improvements can result in time savings of as much as one half hour per day. Of course, people always think they are working to the ultimate degree and that they couldn't possibly be any more productive. But go ahead, conduct the productivity audit and make some changes. Having a practice that is both efficient and effective is well worth the effort.

–by Robert B. Martin
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Section 8

LIBRARIES AND RESEARCH FACILITIES

A WEALTH OF INFORMATION YOU CAN USE

June 1984

Have you ever needed prior years' tax forms for another state? Or perhaps you wanted to get some information on a company or industry or even on a person located in another part of the country. Obtaining material or information from out of state can often be very difficult or so time consuming as to be well-nigh impossible. However, there is one resource center where much of this type of information is readily available to members. That place is the AICPA library.

Many members now utilize the Institute's toll-free telephone numbers to obtain assistance on accounting and related subjects, for example, accounting and auditing for condominiums. Perhaps less well known are the other types of information available. If the library does not have the specific information needed, the librarians will try to track it down and notify the inquirer.

Let's say your interest is certain corporate financial data. The library has a collection of Moody's manuals going back to about 1960 that contains information on bank, finance, industrial and transportation companies as well as on municipal governments and public utilities. The library also has annual reports of NYSE, AMEX & OTC companies on microfiche.

To make it easier for members to obtain information about small businesses, the library has a new service—Area Business Databank. Data is drawn from regional publications and the coverage includes new products, market and management strategies, financial data, economic statistics and business opportunities.

To supplement the *Accountants' Index*, the library has a variety of other indexes. These include *Index to Legal Periodicals* and *Management Contents*, a biweekly compilation of the tables of contents from business magazines.

If you have read an article in a newspaper such as the *Wall Street Journal* and then lost it, the library can help you find it by checking Information Access Company's *Business Index*. Updated monthly, it covers a broad range of business subjects.

Computer literature? Well, the library has a subject/author/publisher index to computer and data processing literature, and another one that covers over 2,000 microcomputer magazine articles each month on just about anything to do with computers—hardware, software, applications, you name it. If you have trouble naming it because you know so little about computers and think a computer magazine might help you learn, the library can assist again with *Computer Contents*—a biweekly compilation of the tables of contents from computer, electronic and telecommunications journals.

While the library will not engage in tax research, it has a wealth of tax information that you can use. Tax forms for every state, reports and decisions of the tax court, IRS letter rulings, capital adjustments, state, federal, international tax information; these items are all on the library's shelves and will never be discarded.

The AICPA library can assist you in many ways so don't hesitate to use the toll-free numbers. In New York State dial 1-800-522-5434. Elsewhere, dial 1-800-223-4155. ☑

A LOCAL FIRM LIBRARY

November 1980

The establishment of an accounting library and the organization, maintenance and control of materials can be rather perplexing to a local practitioner. At the Georgia society's Summer Practitioners' Forum, held recently, Karen Hegge Simmons, the AICPA's chief librarian, discussed the materials and personnel needed in a small library and explained how to set up a budget and acquire, organize and keep track of needed publications. The following comments are just a few of the suggestions Ms. Simmons made in her presentation.

While maintenance of a firm library may not require anyone's full-time services, specific library duties should be part of someone's job description.

The administrative responsibility is given to a partner or manager and consists of establishing library procedures and supervising clerical duties (assigned to one person) such as placing orders for approved purchases, processing materials for circulation and filing them. Overall responsibility—approving the budget, authorizing expenditures and initiating purchases, etc.—should also be assigned to a partner or manager.

Ideally, the library should be in a separate room, but the most important consideration is that the location be accessible to those who need to use the materials. Conference rooms and partners' offices are, therefore, not good choices, but a corner of the staff room, or even shelves in a hallway, could work in a small firm.

In addition to having adequate shelving, consideration should be given to providing sufficient space for study tables, filing cabinets, the card catalog and dictionary stand, equipment needed for storing and using microforms and perhaps even a book cart. Obviously, space needs differ depending on office and staff size, but the following standard guidelines might be of help.

- ☐ A section of standard library shelving consists of seven shelves, each three feet long.
- ☐ One section holds approximately 90 volumes, allowing room for growth.
- ☐ Shelves that are three-quarters filled with books are considered full. This permits some additions without undue shifting of books.
- ☐ Study tables with chairs for six people take up about 18 to 20 square feet per person.
- ☐ Single-reader tables with peripheral space occupy as much as 75 to 90 square feet.
- ☐ Illumination levels of 70 footcandles are recommended to provide adequate lighting.

Organizing and budgeting

The first step in organizing a firm library is to inventory the library materials already in the office. This can be done on 3 x 5 cards, using one card per item (or set), recording the information needed for cataloging. If tax materials are stored separately, access can be provided by cataloging tax material with other materials and using the card catalog as a central access tool for all materials.

The "Suggested Firm Library" in chapter 505 of the AICPA *Management of an Accounting Practice Handbook* can be used as a guide to evaluate the currency and completeness of the library. Items which are on the suggested list and which are to be retained can be stamped with the firm identification, cataloged and shelved. Other items should be evaluated to determine their usefulness.

The firm will probably want to expand the amount of material it keeps on industries in which it has clients. Also, all pronouncements of the AICPA, the FASB and other pertinent rule-making bodies should be retained. Remember, all materials that are indexed in the *Accountants' Index* can be borrowed from the AICPA library for examination.

Library materials which are outdated or which have been superseded and loose-leaf services which have been cancelled should be discarded to prevent their inadvertent use.

Some library expenditures, such as those for periodical subscriptions and services, will be fixed from year to year. You can estimate how much other planned purchases will cost by checking prices in the AICPA publications catalog and in *Books in Print* which is available in public libraries and bookstores. It is best to contact the publishers for prices of tax services because they frequently offer volume discounts. Allowances should be made in the library budget for materials that will be needed if your firm is expanding into entirely new service areas and for shelving, furniture and other fixed assets.

The partner or manager with overall administrative responsibility for the library should become familiar with the publishing patterns of the AICPA, FASB and similar groups and should scan publishers' catalogs, advertising brochures and periodicals such as the *Journal of Accountancy* for announcements of new materials. You can arrange to receive the AICPA library's monthly acquisition list to see what is available both for purchasing and borrowing.

Ordering and controlling

A large percentage of the materials in an accounting library are published by the AICPA, and you can, if you wish, place a standing order with the Institute to automatically receive all AICPA publications. This eliminates the need to send individual purchase orders for new publications.

Library ordering procedures need not be elaborate. A copy of the purchase order can simply be held until the order is received. For prompt service, the order should contain accurate biographical information. Therefore, include the complete title of the item, the author's full name, the international standard bibliographic number (ISBN), if available, and the edition, if there is more than one. All orders and subscriptions should be shipped to the attention of your library. This allows complete processing of the materials and a record to be made of their receipt before anyone uses them.

Having all the right books in the library won't help if no one can find them. You need a system for organizing the materials so they can be retrieved when required. The simpler the system, the easier it will be to maintain.

In small libraries (under 100 books), books can be arranged on the shelves by subject in alphabetical order. Abbreviations of the subject categories can be used to mark shelves and book spines (use pregummed labels or marker pen). This simple system will provide a relatively constant shelf location for the books.

For larger collections (over 100 books), a card file is recommended. The cards should give a basic description of each book—author, title, edition, publisher, date and place of publication and the subject category (which should also be its shelf location). This system shows what is in the library on a particular topic and permits location of materials when only the author or title is known.

Each book should have a checkout card (author and title) which is removed from the pocket, signed and placed in a box or tray in the library when the book is checked out. Materials can then be located by

- ☐ Checking the card file to see if the item is part of the library's collection.
- ☐ Checking the appropriate shelf location to see if the item is in the library.
- ☐ Checking the checkout tray to see who has the item if it is not in the library.

An alternative system (good for magazines) is to have checkout slips, or sheets if the firm is small, with space for the date, title and author of the book, and the name of the person checking the item out. This system works best where items are checked out for a short time.

Make a list of periodicals and keep it in the library so that everyone knows which periodicals the firm receives. Also, you might make a copy of the contents page of each new issue of key periodicals and either route it or post it on a central bulletin board to keep staff informed of the latest articles. Pamphlet boxes are recommended for storing periodicals because they save space and can be marked with the periodical title and retention period. Other materials such as annual reports, cassette tapes, microforms, etc., may require file cabinets, special types of storage and, sometimes, special organization. Consult the library supply catalogs for this type of equipment.

Cataloging

Catalog cards provide a record of items owned by a library and give access to these items by author, title and subject. Obviously, anything can be cataloged, but, as the process is time-consuming, only those items containing information of lasting value should be cataloged. To maintain consistency and to ensure that adequate information will be present to identify a publication, there are several general rules which should be followed:

- ☐ The title page of the publication, not the cover, should be used as the authority for descriptive information. The two are not always the same.
- ☐ A publication is identified by a main entry (on the first typed line of the card) which is usually the author. If there are two or three authors, the first named on the title page is listed as the main author. If there are more than three, the title is used as the main entry.
- ☐ If the publication is an official record of the activity of an organization or is a statement of an organization's official position and no editor or compiler is listed, use the name of the organization as author. Many Institute publications fit this category. Always type the organization's name in full since abbreviations complicate the filing of cards.
- ☐ Always list authors with their last names first (on the first line of the card). List the names of authors in normal sequence after the title (on the second and succeeding typed lines) if there is more than one author.
- ☐ Copy the title (including subtitle) as it appears on the title page.
- ☐ The "imprint"—the publisher and the place and date of publication—appears after the title and edition statement.

A set of three cards—author (main entry), title and subject—should be prepared for each book. The three cards are identical except for the first typed line which is the one by which they will be filed. In the case of subject cards with the same top line, use the distinguishing word to establish order, such as

- ☐ Industry—Banks
- ☐ Industry—Construction
- ☐ Industry—Restaurants

Within each of these sections, cards are filed alphabetically by author (main entry).

The firm library policies should be included in the orientation of new personnel. Everyone who will be using it should know how the library system works and be encouraged to follow checkout procedures when removing material.

The partner or manager in charge should take the lead in fostering a cooperative attitude toward the library and its procedures. It is to everyone's advantage that the library system work.

SELECTED SMALL CPA FIRMS' RESEARCH AND INFORMATION SOURCES

February 1984

Accounting and auditing pronouncements are being promulgated at an astonishing rate. Likewise, the list of financial and economic information sources is growing daily. Managing information has become an important task that all CPA firms must accomplish efficiently and effectively.

To determine how smaller accounting firms are meeting their information needs, we surveyed a number of firms to obtain knowledge of their data sources, the nature of their libraries and research staffs, and the extent to which they use various data bases. Ten firms from California, 11 from Massachusetts and 10 from Virginia agreed to participate in our study. Each firm described itself as a local firm with one or more offices located in the same city or township. Twenty-seven of the 31 firms indicated that they employ fewer than 25 professional personnel at their offices. Each respondent answered a number of questions relating to library holdings, services and data base use. Response distributions were quite similar for the three states, so results have been aggregated in this article.

To assure full compliance with professional standards when providing accounting and auditing services, all firms need to periodically assess the adequacy of their research and data sources and the appropriateness of their means of disseminating information. Our findings and suggestions should, therefore, prove useful for all small CPA firms, regardless of geographical location.

Library holdings

Library resources at the CPA firms surveyed are not very extensive. Only 1 of the 31 firms reports a collection exceeding 5,000 items. Business periodicals such as the *Wall Street Journal* and *Business Week* are rated highest in terms of frequency of use. Various Financial Accounting Standards Board (FASB) publications are also highly rated. Most of the firms indicate they obtain textbooks and industry/client publications regularly but they note these are not consulted on a continuing basis.

Almost all of the firms rely heavily on AICPA publications. Used most frequently among the firms surveyed are: *AICPA Professional Standards* (vols. 1-2), the *CPA Letter, Audit Guides, Accounting Trends and Techniques, Industry Accounting Guides, Management of an Accounting Practice Handbook, Audit & Accounting Manual,* and *Technical Practice Aids.* Publications of other organizations, such as the American Accounting Association (AAA) and the National Association of Accountants (NAA), are purchased and consulted much less frequently.

Services

None of the firms questioned offer very elaborate or sophisticated library services to their professional staff. It could be that these firms believe better services are not needed or cannot be cost justified. However, increasing competitive pressures and the virtual knowledge explosion we are witnessing could cause some firms to alter beliefs of this sort. In the long run, a good resource center could save them both time and money.

In order to assure that library material is used efficiently, it is advantageous to have someone responsible for informing personnel of what is available and for keeping materials up-to-date. Perhaps the best way to provide this service is through the use of a full-time or a part-time librarian. However, this is not always possible so some alternative must be considered.

None of the firms surveyed have full-time librarians, and less than half of them even have individuals employed part-time in the library. Instead, almost all of the firms assign the responsibility for the selection and acquisition of library materials to an officer in the firm.

When it comes to conducting research, only six firms report having individuals in the office with this as their primary responsibility, but five firms say they have written manuals that indicate accepted research procedures. Similarly, fewer than one-third of the firms have specific programs for keeping professional personnel up-to-date on new items and services offered by the office library. However, a few firms indicate they participate in interlibrary loan programs, and one firm (only) has a structured plan for sharing research materials with other accounting firms.

While it is difficult to generalize based on a survey of 31 small CPA firms, it appears that many small firms have limited library facilities and lack knowledge of data bases, computer searching capabilities and information management techniques. Some respondents, however, indicate that they would like to learn more about computerized data base capabilities.

None of the 31 firms questioned have on-line database searching facilities in-house and few take advantage of this resource which is often located at neighboring universities, public libraries or nearby companies. However, one of the fastest ways to obtain information is through the use of on-line data bases and a number of new systems have been developed recently in the field of accounting. These include NAARS (National Automated Accounting Research System), which is a full text data base of annual reports and authoritative accounting literature, available through Mead Data Central (call 800-227-4908) or through the auspices of the AICPA's information retrieval department (call Hortense Goodman, (212) 575-6393)). Disclosure II is another data base covering financial reports of public corporations, available through various on-line services including Dialog Information Services (call 800-227-1927) and Dow Jones and Company (call 800-257-5114). In addition, *Accountants' Index* a bibliographic data base, is available on-line through SDC Information Services (toll-free number 800-421-7229. (In California, call (213-820-4111, ext. 6194)). For additional information on *Accountants' Index*, call Karen Simmons, AICPA library (212) 575-6194.

Firms need to continually consider their information needs and capabilities to assure that their staffs are kept up-to-date and that their clients are receiving the best service possible. From a competitive point of view, firms that keep abreast of technological advances are most likely to be those that prosper. How well a firm responds to client questions could have an impact on both client retention percentages and numbers of new client acquisitions.

We strongly recommend that small CPA firms make a concerted effort to upgrade their research and information sources. It does not necessarily follow that because a firm is small, it needs fewer and less sophisticated sources than the larger firms. Upgrading the library should not be done haphazardly, however. We recommend that firms thoroughly investigate all the available research sources, since there are many on the marketplace and not all are suited to every CPA firm. And, of course, the costs and benefits of various sources must be considered. For very small firms it might be best to consider sharing research materials with other firms or using the resources of a university or public library.

In addition, practitioners who are AICPA members have at their disposal toll-free telephone access to, and borrowing privileges from, one of the most complete and up-to-date accounting libraries anywhere—the AICPA library. For a complete copy of the *Library Guide* or for further information, call 1-800-522-5434 in New York State; or 1-800-223-4155 in the rest of the United States, including Hawaii, Alaska, Puerto Rico and the U.S. Virgin Islands.

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A LOCAL FIRM'S COMPUTER LENDING LIBRARY

November 1984

With microcomputer usage now commonplace, it is becoming critical that local firms also avail themselves of this technology. We first installed microcomputers in our offices three years ago and found they resulted in substantially greater productivity. Not only do the systems allow us to accomplish such tasks as setting up 14-column worksheets quickly, but they also enable us to meet our clients' needs for increasing amounts of information.

We came to the conclusion, earlier this year, that an accountant without a microcomputer today is in much the same position that an accountant without a calculator was some years ago. It was time for all of our employees to learn how to use one. The crucial question was how best to accomplish this.

After considering a number of options including buying computers in bulk and subsidizing part of the purchase price for employees, we decided to create a computer lending library. So far, we have spent about $15,000 on hardware, which is more than the firm would have spent using one of the other approaches. Moreover, this cost does not include the time spent by supervisors and staff to teach or participate in the lending program's computer training workshops. A lending library, however, best met our requirements for a program that wouldn't cost employees too much.

At present, attendance at a workshop is required of all employees who wish to participate in the library program. Workshops last for an entire day and we can train up to twelve employees at a time with two people to a machine. Rather than tie up our own microcomputers for this purpose, we utilize the training facility of our local computer vendor.

A workshop session covers basic system hardware and details about the computer operating system. The largest block of time, though, is devoted to teaching participants how to operate Lotus 1-2-3©, a spreadsheet program that is used extensively at our firm. Workshop participants have the opportunity to create their own templates and to take these diskettes with them for use as a starting point when they borrow a machine from the library.

The library consists of four IBM-compatible portable computers which are equipped with operating software and Lotus 1-2-3©. The first step in activating the lending library was to invite staff members to sign up to borrow the computers for three-week periods. (We would hope to extend this time when all interested staff members have had a chance to borrow a machine.)

The offer generated considerable interest and over a quarter of the firm's employees have already accepted it. We have high hopes that the enthusiasm of the initial participants will encourage others who may be apprehensive about using this equipment.

Some employees already have some microcomputer experience but not necessarily on IBM-compatible equipment. For example, one of our senior accountants has an Apple IIe at home. Many of our clients use IBM computers, however, and borrowing one of our compatibles gave him a chance to learn how to utilize software for these machines.

Others have no previous experience and find that learning to use a computer by constantly referring to the instruction manual is a laborious process. We hope the library program and workshops will help alleviate some of these problems.

We have about a dozen microcomputers and make extensive use of them, not only for client servicing but, also, in four particular areas of firm management. For example, the firm previously used a service bureau to maintain its tax calendar. Now, a tax calendar is maintained in each office on a microcomputer.

We believe in the philosophy that our own firm is our most important client and that we should employ effective management techniques that will help us realize our objectives. Accordingly, we maintain a firm budget using a spreadsheet program and a microcomputer. The budget is prepared annually on a month-by-month basis with actual performance being entered monthly. We then analyze variances between budget and the prior year.

Regular contact of clients and referral sources is very important to us and to ensure that this is done, we use a microcomputer with a hard-disk drive. This enables us to maintain a data base on all clients that includes the name of the person to contact at those clients' offices, their bankers, attorneys, referral sources and various people with whom they do business. We can conduct searches for different relationships, target specific people and access that data base from other locations.

Management workload analysis is the fourth area where we make extensive use of microcomputers. We maintain a record of each manager's client activity (the fee volume, etc.) and analyze this data each month to monitor each one's performance.

In connection with our scheduling function, we use a microcomputer to monitor the firm's capacity. In addition to checking chargeable hours from period to period, as is traditional in CPA firms, we also monitor our performance versus our capacity. By budgeting vacations, holidays and sick days, we develop firm-capacity figures by time period. These statistics enable us to measure how well we are utilizing our professional staff. ☑

—by Ted M. Felix, CPA
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Section 9

COLLECTIONS

A BUSINESSLIKE APPROACH TO COLLECTIONS

December 1989

The October issue of the *Practicing CPA* contained an article on the firm administrator's role in rounding up receivables. This article will deal with organizing a CPA firm to improve the collection process. Some of the suggestions will reinforce those made a couple of months ago. The theme will be familiar to many. I've written the article from the point of view of a practitioner in a local accounting firm who has faced these problems for many years, taken his lumps, and learned from his mistakes. Frankly, that's exactly my experience.

Just how should a CPA firm organize itself for the collection process? In today's unforgiving world, this question is paramount. Everyone recognizes the need for a more businesslike approach to the financial management of an accounting practice, but few people have the desire or the knowledge to affect change. This article will explore the more routine aspects of setting up an effective, controllable collection system, with the goal of maintaining strong client relationships.

Reaching agreement on three key points is essential to establishing an effective collection system. The first is the "past due" point. Normally, 30 days from invoice date is appropriate, but certain situations (such as large jobs or specialty work) might demand a shorter time frame, say 15 days. Invoices should be dated the last day of the work cycle, not the date the invoice is typed or mailed. This approach provides an orderly dating of invoices over the annual cycle and an incentive for prompt billing.

The second agreement needed is the "stop work" point. Generally, 90-120 days from invoice date is appropriate. The "stop work" point is just that—if an account remains past due at this point, all ongoing work ceases. No exceptions! Success of such a policy depends on clear communication with the client at the onset of the relationship. Prospective clients should be informed of this rule in the beginning and should not be accepted without their concurrence. Success also depends on the cooperation of the partners in maintaining a high level of enforcement. Debate about the "stop work" point and agreement among the partners on the appropriate time frame should be handled at a partners' retreat. Unless everyone cooperates, this policy will become more of a joke than a rule.

The "outside help" point is the third area where agreement should be reached. Usually, 120–150 days from the invoice date is appropriate. If an account remains delinquent at this point in time, it should be considered for referral to outside help with the collection process. Again, clear communication with prospective clients, and cooperation and agreement among partners is essential. Remember, when this point is reached, you must generally prepare to abandon the client relationship. More on this aspect will be presented in the second part of the article.

The first level of internal collection effort should be handled by your administrative staff. Ideally, your firm administrator, or if lacking one, your office accountant, should telephone the client's administrative staff, most likely the controller, bookkeeper, or accounts payable clerk. The first contact should occur two or three days after the "past due" point. After introduction, your administrative staff person might say "I noticed that our invoice #1016 for $7,200 is three days past due and was wondering if there is a problem." A typical reply might be "No, no problem, it just hasn't come through our cycle for payment." The appropriate response then is "Under the circumstances, when can we expect your check?" If the date given is acceptable (one to two weeks), your administrative staff person should thank the client and explain that you will expect payment at that time, then mark his or her calendar for a follow-up call two or three days after that date if payment has not been received. If two or three follow-up calls do not produce results, the administrative staff person should refer the matter to the engagement partner. If the date given is unacceptable (over two weeks), the client should be thanked and the matter referred to the engagement partner immediately for follow-up with the client.

Another typical response is "Yes, there is a problem. I thought Mr. Jones was going to have a heart attack when he saw your invoice, and he keeps shuffling it to the bottom of the stack." Your administrative staff person should thank the client and say that he or she is referring the matter immediately to the engagement partner who will contact Mr. Jones to work out any differences. Many clients offended by perceived unreasonable invoices will internalize their feelings, hold back payment, and make no effort to inquire directly. If such a situation persists, you can almost guarantee a lost client down the road. Prompt attention from the engagement partner when informed of such circumstances will almost always save the day. This is not a time to be timid or shy.

Having administrative personnel make the first contact relieves the partners of this burden and will accomplish the prompt collection of a substantial portion of your receivables. In addition, it pinpoints trouble spots, referring those to the engagement partner for immediate action. Again, it is essential that all partners agree that such a communication demands immediate attention.

In addition to the internal contact program, a formal, systematic procedure for reviewing accounts each month should be established. Someone (usually the managing partner) should be appointed collection partner. Although there are many approaches to systematic review, a monthly meeting between the collection partner and each engagement partner, one on one, seems to work best. At this meeting, the collection partner should review every account with an outstanding balance, past due or not, with the engagement partner, whether that partner or a subordinate writes the invoices. In preparation for this meeting, the engagement partner should discuss the status of all routine receivable situations with the administrative staff person responsible and make all appropriate client contacts. He or she should be able to inform the collection partner of all the facts and circumstances of each client situation. If the engagement partner is not able to do this, the purpose of the meeting is defeated, and such conduct should not be tolerated.

As each account is discussed, the engagement partner and the collection partner should agree on appropriate further actions, when necessary. Such actions might include further telephone contact by either the engagement partner or the managing partner, a visit to the client's office with the intention of picking up a check or as an attempt to obtain a personal guarantee of the account, a note for the account balance, or the enforcement of the "stop work" point or the "outside help" point. I suggest that both parties make notes of the decisions made on an account-by-account basis.

At the following month's meeting, these decisions should be reviewed to determine if the engagement partner kept his or her agreements for follow-up action. Failure of the engagement partner to appropriately follow-up, over a one-month span, as promised, should not be tolerated. Again, agreement on these policies by all partners at their retreat is imperative for successful implementation.

It is my experience that these monthly collection meetings will last no more than 15–90 minutes each. Although time-consuming for the collection partner, they are necessary for maintaining proper internal control over outstanding receivables. And although busy with client work, the engagement partner must give a high priority to handling collection responsibilities. All the partners should agree that such activities are consistent with a businesslike approach to the management of their accounting practice and are just as valuable as chargeable time.

Here are some ways to improve collections:

- ☐ *Never mail a time bomb.* You know when you have written this type of invoice. There are usually strong justifications for an invoice significantly in excess of what the client expects. Don't mail it, though. Such an invoice demands a personal visit and an explanation. Work out any differences on the spot. The engagement partner should take the managing partner to this meeting if the situation is expected to be especially difficult.
- ☐ *Adopt rigorous client acceptance procedures.* Sometimes with just a little checking in the beginning, a nasty situation can be avoided. While beyond the scope of this article, client acceptance procedures are essential, and determining the ability to pay is a significant aspect of those procedures. Utilize credit and reference checks and avoid accepting clients with marginal ability to pay.
- ☐ *Use engagement letters as a collection tool.* Be sure that your engagement letter clarifies, among other things, your fees and payment terms. Have a clear understanding of what you're going to charge and how you expect to be paid. Keep the client advised of any potential overruns if you have quoted a fixed or maximum fee. Be sure to get written permission before you exceed your fee quote.
- ☐ *Always get a retainer.* Any new client should be willing to advance you approximately 50 percent of the estimated fee for the initial assignment upon your acceptance of the engagement. An unwillingness to do so is a strong indication of potential payment problems later on. Further extension of credit should be based upon credit and reference checks and upon your experience with the client. Be sure to get something substantial up front to verify the client's serious intentions.
- ☐ *Get a personal guarantee of all nonindividual accounts.* Have your attorney draw up a simple personal guarantee form that you can complete for each new client where appropriate. Make it standard practice to obtain such guarantees and inform prospective clients that this is a firm rule and is necessary if you are going to do business together. Anyone unwilling to give you such a guarantee does not give you the confidence that you are dealing with a financially sound individual. Be willing to turn away business when such a guarantee is refused.
- ☐ *Get a note covering the account balance.* When you have the slightest indication that an account may be in trouble, insist on obtaining a note for the account balance guaranteed by the appropriate responsible persons. Again, your attorney can develop a note which will allow easy completion. The importance of such instruments will be discussed further in the second part of this article.
- ☐ *Be a pest; clients pay them first.* A high level of collection contact whether by the administrative staff or the engagement partner, will move your bill through the payment process faster. Once clients understand that you have a systematic review procedure, and that you will

contact them every time an invoice slips past due and will follow up on promises made, they will be more likely to put your invoice on the "pay" stack rather than the "hold" stack.

- ☐ *Comply with all regulatory authority rules, but don't otherwise release copies of workpapers without getting paid.* Each governing body has different rules concerning the retention of client documents and your work product. Be sure to inform yourself of those rules and avoid violating them. If ethically and legally possible, use your work product as a lever for obtaining payment in difficult situations.
- ☐ *Impose finance charges.* Figuring finance charges on a monthly basis can be a nuisance, but there is software available to help. There are also numerous federal and state statutes governing finance charges, and it is necessary to stay in compliance. So first, seek legal advice on the proper way to impose them.

  Second, charge everybody. There should be no privileged clients. If you get a complaint, say "Charlie, our rule is to impose finance charges on all accounts unpaid after thirty days. Since this is the first time this has happened on your account, I will waive the charges this one time if you send me a check for the difference right away. You pay finance charges on your credit cards and department store bills routinely without complaint, and you should understand that our need to be paid is no different. In the future, get your payment to us within thirty days, and you'll never see a finance charge on an invoice again."

  Remember, it is essential that all partners cooperate in this effort. Once you begin singling out certain clients for exemption, you will lose control of the process.
- ☐ *Consider accepting credit cards.* Obviously, this policy is more appropriate to some practices than to others. All practices have certain clients who would appreciate such an alternative, however. Paying a small discount for immediate payment seems a worthwhile expense, so improve your cash flow by having this option available.

The two keys to avoiding collection troubles are appropriate and proper client communication and partner cooperation. Your collection policies should be explained to prospective clients orally, and again in your engagement letter. Appropriate reminders of these policies should be given when necessary as time goes by. Holding a meeting with new clients on how you expect to be paid will go a long way toward avoiding collection troubles in the future. Clients will respect a businesslike approach to collection. In addition, having a high level of commitment to the collection process from partners is vital. Without strong agreements and the enforcement of those agreements on an ongoing basis, the collection process will have no teeth.

These two goals are not easy to achieve. In some cases, it may mean a change in firm culture to establish them. But remember, it's an unforgiving world and it's becoming more unforgiving. The thrill of accomplishment is negated when you aren't paid. Keep in mind that my advice to you, as a consultant to the profession, is no different from your advice to your clients regarding their receivables. ☑

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A BUSINESSLIKE APPROACH TO COLLECTIONS (PART 2)

January 1990

Last month, in the first part of this article, I examined routine alternatives available to the typical accounting practice organized to improve the collection process. Unfortunately, even though privy immediately to significant financial information concerning prospective clients, CPAs still make mistakes, taking on those with marginal ability to pay. In the new competitive environment, and without the resources to do much screening, many CPA firms are taking on every new client they can. Call it greed or survival, those they turn down are few and far between. Although many firms have adopted client acceptance procedures, with determining the ability to pay a significant portion of those procedures, even the strictest will someday face a significantly troubled account. In this part of the article, I will examine how to deal with troubled receivables, looking at the options available when all internal efforts to collect have failed.

Going beyond internal collection efforts means playing hardball. It almost certainly portends a decision on the part of the firm to abandon the client relationship. With competition for clients so fierce, that's a difficult decision for some. But let's stop kidding ourselves—do you really want to do business with someone who isn't going to pay, or who, at the least, is going to give you a hard time about it? Instead of hassling with these people, wouldn't the time be better spent trying to obtain new clients or in efforts to extend services to present clients who *can* pay? Part of adopting a businesslike approach to collection means facing this tough decision squarely and letting those who cannot or will not pay, for whatever reasons, find someone else to service their needs.

Before going for outside assistance, I strongly suggest that the engagement partner and the managing partner review the work performed for the problem client in order to assess the possibility of a counterclaim. It is essential to determine the quality of the work performed and to uncover any potential liability exposures. The intensity of any further collection efforts should be tempered by the situation.

With this caveat in mind, I suggest you first turn to a letter-writing collection agency. Those agencies offering this service provide a series of ever more intense, computer-prepared letters which will be sent to your clients on your instructions. Most offer both a series of letters that, while becoming more insistent, remains polite, and a series that becomes tougher over time. Generally, you control which series is used, on a client-by-client basis, and the interval between letters. No individual contacts your clients.

If you receive payment in the interim, a telephone call or a mailed form stops the process. These organizations do not charge a percentage of the amount collected; instead, they charge a relatively inexpensive flat fee per letter series. Normally, the client is unable to distinguish this activity from that of a full-service collection agency, and, as a result, its use can be highly effective. When trying to decide upon an organization of this type, ask for references, especially from CPA firms. I find fellow practitioners most willing to share information about their use of such services.

Failing results, I suggest you next turn to a full-service collection agency. Such agencies handle each account turned over to them individually, and their activities usually include repeated letter writing, telephone calls, and visits to the client's office. Good collection agencies are persistent. If they are unable to generate full payment, sometimes they can arrange for partial payment, settlement, a note, a payout agreement, collateral, or an agreed judgment. Many have ongoing relationships with collection attorneys who handle all their work for a fee you could not arrange on your own because it is dependent on the volume of work generated. Naturally, they only make recommendations if they feel legal action is the only recourse. The decision to sue or not remains yours.

Before you say "I can't have such people contacting my clients," remember with whom you are dealing. Enormous effort has already been made to collect these accounts; continuing to handle your delinquent client with kid gloves just isn't going to be effective. It's time to get tough. So let someone else be the bad guy.

Once an ongoing relationship with a collection agency is established, turning over an account is relatively easy. It usually means completing a form and including with it copies of your engagement letter, any other written fee agreement, unpaid invoices, collection correspondence, and notes, personal guarantees, and any other useful information. A good collection agency will keep you informed when there is activity on specific accounts and will meet with you, say quarterly, to review the status of all accounts. Normally, you pay a minimal charge for forms and a contingent fee of approximately 20–25 percent of anything collected. If turned over for legal action, the contingent fee will probably increase to 30–35 percent, plus court costs.

Before you blanche, remember that anything collected at this point is found money, so don't begrudge the agency or the attorneys their fee. Be sure to review all form letters that might be sent to make certain they fall within the bounds of ethical and legal conduct. Again, check the agency's references, calling your fellow practitioners or others who have used the service. I have experienced dramatic results from the use of commercial collection agencies and strongly recommend that you engage one that operates within the parameters of appropriate business behavior.

If you have exhausted these means, it's time to pause and reflect. The only remaining available step is legal action, and that step requires careful consideration before being taken. At this point, I suggest you make a determined effort to settle for a significant reduction in the fee, say 50 percent, or even more, depending on the circumstances. It is always preferable to settle a disagreement amicably than to drag the issue through the courts. Legal action is time-consuming, expensive, and risky, and it is a step that should not be taken lightly.

The following may help you with this decision:

- ☐ *Reconsider the quality of the services performed.* If there are any real exposures, do not bring a lawsuit. If you do, you're inviting a malpractice counterclaim. Even if you have malpractice insurance, you will most certainly be out of pocket the deductible—no longer an insignificant amount in most cases. Most malpractice insurance carriers would prefer you never file a collection lawsuit. While that policy is not necessarily a good business practice, if you gain a reputation for filing indiscriminately, and draw a few malpractice counterclaims, you may find yourself unable to obtain coverage in the future. Be certain of the quality of your services before you file.
- ☐ *Set a reasonable threshold for legal action.* Frankly, it isn't worth filing a lawsuit (other than in small claims court) for less than $10,000. The time, trouble, and expense suing for amounts below that threshold just aren't worth it. Finding an attorney willing to accept such a case for a contingent fee isn't easy. Those who are willing usually will not touch a low dollar volume case, as it isn't worth their time and trouble for the potential small realization. On the other hand, if you choose an attorney who charges by the hour, you may wind up

spending more on legal fees and court costs than any potential recovery likely on a smaller claim.

- ☐ *Go to small claims court whenever possible.* Most jurisdictions have a small claims court where you may be able to press your claim yourself, without the aid of an attorney. Although the maximum claim is usually relatively small ($2,000 – $3,000), it is sometimes fairly easy to get a judgment with much less hassle and expense. Consider using your firm administrator as a liaison with small claims court. Supervise his or her work, but let the firm administrator prepare the appropriate forms, handle the filings, and make the court appearances until such time as a partner's presence is required. I suggest you have an attorney set up or review your procedures at the beginning and remain available for consultation on specific cases. Again, set a threshold, probably $500, and don't bother with situations that might yield less.
- ☐ *Don't beat a dead horse.* Before suing, make an effort to determine whether or not you *can* get paid if you win. What use is it to sue if the client and/or any guarantors of the client's debt are unable to pay or convert any assets to pay your judgment. As the client's CPA, you should have some knowledge of the financial situation. Additionally, the collection agency is usually able to provide an evaluation. There were many occasions when my collection agency advised against filing a lawsuit because of the belief that the client's assets were insufficient. Obviously, it is not worth pursuing such situations.
- ☐ *Be a business person—forget "The principle of the thing."* I know how you feel. You performed good and valuable services and gave the client your best, and it hurts to get stiffed. But principles aside, filing a legal action is a business decision, not a personal one. Don't let your feelings become involved. It's either a good business decision or a bad business decision to sue, so trust your business judgment, not your emotional response.
- ☐ *Never sue without a note.* In the first part of the article, I suggested obtaining a note for the account balance as soon as you have the slightest indication the client may be in trouble. It's much easier to obtain a note when you have unfinished work to deliver to the client later, or there is still a semblance of an ongoing relationship. Asking for a note after an expensive unsuccessful collection effort is a joke. So do it early while the client is still expecting something or is negotiating.

Although the legal implications are beyond the scope of this article, my attorney friends advise me that it is significantly easier and far less risky to obtain a judgment when there is a note for the account balance, instead of just an open account. They have also advised me that your risk of losing a malpractice counterclaim is significantly diminished when there is a note. I strongly advise that you consult with legal counsel on this issue before establishing policies and procedures.

- ☐ *Focus all collection lawsuit activity through one partner.* Your collection partner (probably the managing partner) and your firm administrator should assume responsibility for all collection lawsuit activities. It is vital that someone maintain responsibility for the big picture, so relieve the engagement partner of his or her responsibilities for collection when you reach the lawsuit stage. Making consistent decisions is imperative, and that can't be accomplished if each engagement partner is primarily responsible for collection lawsuit activities on his or her own accounts. Since you're abandoning the client relationship anyway, it is best to focus any continung activities through someone other than the partner who handled the account.

Generally, the engagement partner will be relieved and more than happy to turn over the problem. Working together, the collection partner and the firm administrator should maintain all contact with legal counsel, keep appropriate records, reply to all communications, and report to the other partners on the status of legal activities.

- ☐ *Be prepared to spend time dealing with the process.* Because of our crowded court system, collection lawsuits tend to drag on. Activity occurs in spurts, with long periods of inactivity in between. It may take several years for your lawsuits to wend their way through the court system, assuming settlement is not negotiated along the way. Prompt attention to communications and requests for information is vital, so the responsible partner must be prepared to take the time to keep the process moving along.
- ☐ *Beware the Deceptive Trade Practices Act (DTPA) and Racketeer Influenced Corrupt Organizations Act (RICO) malpractice counterclaim.* Many defense attorneys have become clever in opposing collection lawsuits. If your receivable is in serious trouble, it is probable that other creditors of your client are in the same boat, and they may be contemplating or filing collection lawsuits also. Attorneys defending such claims are becoming more aggressive and filing counterclaims under DTPA and RICO. Many times, such filings are intended as scare tactics because of the potential for treble damages in both situations. Many a collection lawsuit has

been stopped dead in its tracks because of an unwillingness to assume the risks associated with these acts. As a result, these situations often result in a mutual dismissal, gaining you nothing but legal fees and headaches.

Your best protection against such claims is to be certain of the quality of the services provided before filing suit. While the AICPA and many legislators are working hard to change the RICO Act to eliminate its application to civil situations, a recent Supreme Court decision validating it in the civil arena means that nothing short of an Act of Congress will change the status quo. Be sure to discuss these potential exposures with legal counsel each time you are considering a collection lawsuit.

Playing hardball with troubled receivables requires good business judgment, a willingness to divorce one's self from the emotional aspects of the situation, a keen sense of the risks involved, and strong outside support, whether from a solid, reputable collection agency or experienced legal counsel, or both. In addition, policies and procedures adopted in connection with such activities must be well thought out and agreed upon by all the partners. While some firms avoid taking any action on troubled receivables beyond internal efforts, thus avoiding any risks whatsoever but forfeiting any potential rewards, I would suggest such a course only where all the partners are extremely adverse to risk. A well-planned, well-managed program using competent outside help can improve your business reputation and enhance your cash flow. Remember, however, one piece of advice: Settle when you *don't* want to. Settle for *less* than you think is fair. Settle *quickly*, if you can. File a lawsuit *only* when all other avenues are exhausted, and do that *only* in situations where you are certain of the quality of your work. ☑

—by **Alan D. Westheimer, CPA,** *770 South Post Oak Lane, Suite 650, Houston, Texas 77056, tel. (713) 623-8911, FAX (713) 623-8914*

QUESTIONS FOR THE SPEAKER

May 1981

Here is another question from the AICPA's 1980 series of practice management conferences. The response is by Jerrell A. Atkinson, CPA, of Albuquerque, New Mexico.

Question: Can you give some data on accounts receivable as a ratio to billings? Also, on the concept of charging interest?

Atkinson: Several surveys made at management of an accounting practice meetings and conferences yield this data. Information is as follows:

Accounts receivable as a percentage of annual fees

	New Mexico society MAP conference	Missouri society MAP conference
High	26%	25%
Low	13%	14%
Average	18%	19%

Work in process as a percentage of annual fees

	New Mexico society MAP conference	Missouri society MAP conference
High	10%	17%
Low	4%	9%
Average	7%	13%

Information as of October 1980. Based on 20 firms reporting in the New Mexico survey and 134 firms reporting in the Missouri survey.

Charging interest? We believe in charging interest on past-due accounts for three reasons:

- ☐ Clients who pay promptly are discriminated against if you don't charge interest.
- ☐ Charging interest seems to speed up some clients who pay slowly.
- ☐ The charge covers the cost of monthly billing. Our rate is 1 percent per month on accounts over 30 days.

Others have different opinions about charging interest. However, we have found it to be effective in the past five years.

A PHILOSOPHY OF ACCOUNTS RECEIVABLE MANAGEMENT

June 1984

Anyone who is not insistent about being paid for services rendered is likely to find that people take advantage of the situation. It is the squeaking wheel that gets the grease. Tardiness in paying usually has little to do with clients' perceptions of whether value has been received or whether they are satisfied with the product or service. It is simply that people don't like parting with their money. Because of this tendency, we believe that the best way to manage accounts receivable is to first establish a fair system and then to be firm about collecting the fee.

In reality, you are not doing people favors by allowing them to incur large fees without discussion as to how and when these fees will be paid. Clients become embarrassed when fees are delinquent and will begin to avoid you. This ultimately leads to their not receiving needed services and your not receiving any money. The better approach is to meet the problem head-on and work out a plan for repayment. From that point on, the account is not considered delinquent and clients are more at ease.

We believe that it is a mistake to bill clients for more than you intend to collect. Billing adjustments should be done before the invoice is rendered, and once the receivable is recorded, you should have every intention of collecting it.

Adopting this policy places you in a position to determine which accounts or portions of accounts are to be treated as "charity" at the time the service is performed. You will then have a better grasp of what percentage of your services are performed for less than regular fees. Billing more than you intend to collect hides this statistic.

You must not undermine the system by accepting terms more liberal than previously agreed upon. To avoid this, we strongly advocate that all billing matters be handled by someone other than the professional practitioner. We have such a system in our firm and have successfully implemented similar systems for other professionals. ☑

—by Joe D. Jones, CPA
Jackson, Mississippi

SOME ACCOUNTS RECEIVABLE COLLECTION IDEAS

October 1985

In talking with other CPAs, it appears there is a universal problem—the collection of our accounts receivable. Many practitioners and firms say that accounts receivable and work-in-process are reaching levels of over 100 days of productivity. Several reasons are given, such as poor economic conditions or high tax bills, yet seldom does anyone admit to being too busy or too preoccupied to manage accounts receivable properly.

In many cases, I suspect that it is mismanagement that is the real cause of poor receivables collection. If we took the time to review our own systems the way we do our clients', I don't think we would have accounts receivable collection problems.

A quote by a speaker at a recent AICPA small firm conference really hit home with me. He said that as partners or shareholders we should treat our own firms as our best client.

As CPAs, we drill into clients the necessity of timely billing, follow-up and collection, but we seldom practice what we preach. We bill clients when engagements are completed, rather than using interim billing, and we hesitate to ask for retainers from new or unfamiliar clients. We bill once a month (if that) rather than twice a month and don't have a secretary or bookkeeper telephone when an account is a month past due. We refuse to take a few steps that could alleviate the problem because we are too busy with client work.

To achieve better collection results, I suggest the following:

- ☐ Bill once a month or, better, twice.
- ☐ Send follow-up unpaid-balance reminders every 20 days.
- ☐ Have a secretary, bookkeeper or office manager contact all accounts that are 45 days delinquent.
- ☐ Repeat this for all accounts that are 60 days delinquent.
- ☐ Make any accounts that are 90 days delinquent the responsibility of the partner or CPA performing the work. This individual should personally contact the client.
- ☐ If any account is 120 days past due, consider turning it over to a collection agency—a drastic step few firms are willing to undertake.

I am by no means suggesting disregard for clients by the adoption of these procedures. What I am suggesting is that we care for our own needs as well as we care for the needs of our clients. Given the benefits of sound business practices, our professional practices will reward us handsomely. ☑

—by Mark J. Soukup, CPA
Fort Collins, Colorado

Section 10

MANAGING FOR SUCCESS

MANAGING A CPA FIRM LIKE A BUSINESS

May 1985

In order to operate a successful CPA firm in today's economic conditions, practitioners must be hard-nosed businesspeople as well as ethical professionals. However, not all partners in a firm are business managers; some are accountants and only that. Our successful clients all have a chief executive, and CPA firms must have strong leadership, too, if they are to prosper. What most CPA firms really need, in fact, is a benevolent dictator—someone who can provide direction and effectively organize people and activities to accomplish the firm's objectives. Such a person must be able to both make decisions and delegate duties.

In our firm, the managing partner makes the decisions, but various committees are responsible for the setting of policy and timely completion of tasks. We believe that the firm should operate as a single entity, and our policy is that once the firm is embarked on a course, everyone must be fully committed to following that course. We believe, too, that if the firm is to be successful, the managing partner must be allowed to make mistakes and be able to take risks.

The first thing we have to understand if we are to manage our firms like businesses is that our clients don't love us. They don't come to us in good years and suggest that we raise their fees. The only way to realize higher fees is for the managing partner to make sure that everyone in the firm believes in his or her worth. To be effective, the managing partner needs to be a high-energy person who believes in motivation and control.

The product we are selling our clients is time. Therefore, control of time is important. There is, however, a diversity of opinion as to what constitutes chargeable time. Few firms have formal policies on charging time to clients, and staff often don't understand the importance of accurate charging procedures. We believe that if all time is recorded (and these days, every firm should process time through a computer) we have a chance to bill it.

We expect 1,500 to 1,800 chargeable hours a year per staff person and 1,200 to 1,400 chargeable hours a year per partner. In our firm, the time spent on a job is the responsibility of the line partner, and the managing partner is there to help—to give support when needed.

There are numerous formulas in use for setting fee rates. Our formula is weekly pay divided by 32, times 3, plus a little. We find this puts people into categories, and we can then take the highest figure in a category and use this as the standard for all people in that group.

Every partner receives a monthly report of time chargeable to his clients. He then must meet with the managing partner or his administrative assistant before any bills are sent out. This encourages the partner to bill for a task that he might not bill on his own and gives him the backbone to bill somewhat higher than he ordinarily might. In effect, it is an outside review of a partner's billing methods that works to the firm's advantage.

There is a tendency for standard time to become a maximum. We think that for every client under standard, there should be some who are over standard. That is where value billing comes in. We don't retain clients who are below 70 percent of standard. We believe you have to be willing to lose such clients and increase billing on the other ones. It is imperative to constantly review time, to consider the merits of value billing and to increase fees. We believe in the philosophy of being strong. Don't have sympathy for poor clients.

Getting bills out on time and collecting fees for services rendered is crucial to the firm's success. When possible, fees and billing arrangements should be discussed at the first meeting with a client. You should establish credit limits and, for clients whose credit rating is an unknown factor, think about obtaining a retainer before commencing an engagement. You might also consider charging interest, such as one percent a month, on delinquent accounts. To make partners responsible for billings and collections, we reallocate income based upon poor performance in this area. This penalizes those partners below the average and benefits the others.

As well as the usual tax, accounting, auditing and quality control and review departments, our firm has separate financial planning and computer departments, each of which does its own billing. To further promote firm efficiency, there is a separate administrative department with three administrators whose responsibilities include billings, scheduling and CPE requirements.

Some thought might also be given to employing an office manager to be responsible for administrative activities. Some firms find this beneficial because an office manager has no conflicting interests, administrative duties can receive full-time attention, and partners can then spend more time on revenue-producing activities.

Effective communication is important. Instead of holding formal partner retreats, we have six to eight meetings a year. The purpose of these meetings is to encourage the free flow of ideas, improve partners' performances and build a team. It is the managing partner's responsibility to make sure that partners develop management as well as technical skills so that maximum use can be made of all resources.

We are very active in state society and civic affairs. This exposure is good for business in general and is helpful in mergers with and acquisitions of other practices. Marketing and public relations efforts have become an "absolute must" for local firms today. We hold about four seminars a year for certain clients and for bankers, and can accommodate up to 25 attendees in our office. Other promotional activities include mailing 1,500 copies of our client newsletter each month, using brochures and having a booth at the New York State Society's accounting show.

Following these policies has enabled us to produce a net income of between 40 and 45 percent of gross fees, and growth from an annual revenue of $19,000 in 1961 to $250,000 in 1970 to $7,000,000 in 1985. Remember, you are operating a business; be strong and you'll be successful! ☑

—by Robert L. Israeloff, CPA
Valley Stream, N.Y.

MANAGING FOR PROFIT

January 1988

When I became managing partner of our firm in 1976, I decided to give up practicing accounting and become a manager. It took many years to reduce my accounting role, and presently I am responsible for about 300 to 400 chargeable hours per year.

As I became more and more involved in the management process, I developed six management principles which, collectively, have proved most effective in enhancing the profitability and efficiency of our firm.

Financial and other goals

I quickly learned two things about managing. The first is to get rid of negative influences. The second is to take your own advice as a CPA about budgets. It is essential for anyone operating in today's environment to have a financial budget on the accrual basis. This gives management consistent information against which to judge its financial accomplishments. It allows the firm to control its expenses by knowing in advance what the expenses should be and to compare the actual results against anticipated results.

Not only should financial goals be established, but personnel goals should be set and adhered to. You need to have goals for partners involving time spent on chargeable work, time spent on administrative chores, and time that is to be spent on practice development.

Practice development goals require further detail such as the number of new contacts partners and staff will make during a year, how many goodwill visits are to be made to the firm's largest clients, and the number and dollar volume of new clients to be brought into the firm by each partner.

People should be judged on the basis of whether or not they have achieved their goals. Efforts should be monitored regularly. (The monitoring can be handled by administrative personnel.) The achievement of specific goals should then play an important role in the compensation of partners and staff.

Get involved in the political process

Every day of our lives, we, as accountants, have the unique opportunity to see the impact of the government's involvement in the lives of its citizens. Yet because we tend to have passive natures, we do little to influence the government's actions.

We must develop power and influence in our communities and become known as people who have something to say. We are, oftentimes, in the best position to have the requisite knowledge and to explain what the government's actions mean. Yet we don't!

We should strive to become the leaders of civic and political organizations, and make strong efforts to participate in the political process. A good leader within the firm should take his or her leadership skills and use them in the community at large. We have a responsibility to inform and educate. We must get involved.

Organizational attitude

We must always remember that the leader's attitude permeates the entire firm. If we are negative, it becomes the mood of the organization. Therefore, regardless of economic and other conditions, the leadership of an organization must display a positive attitude at all times.

Develop a management information system

The development of a management information system that monitors all financial and partner and staff goals is essential for the efficiency and profitability of the firm.

Particular attention should be paid to the collection of accounts receivable. This is an area where most accountants are somewhat timid. Isn't it amazing how clients often require the work yesterday but seem to forget that they have to pay?

In our firm, we have developed the following system regarding the collection of accounts receivable: One individual has been assigned the role of monitoring and administrating all of the accounts receivable on a part-time basis. This person meets with each partner regularly to discuss arrangements to be made with clients regarding collections, write-offs, and markdowns, and then is required to call, every month, those clients who have not paid during the previous month. These calls are generally gentle and friendly reminders to speed up the collection process.

All information gathered by the accounts receivable clerk is provided to the managing partner. This enables the managing partner to use his influence in getting the partners to follow the procedures that they have outlined for the collection process.

We also take a very tough stand with regard to clients who refuse to pay. We sue. This may be contrary to the generally accepted principles of accounts receivable collection. Our position, however, is that if clients leave us and if they decide they no longer owe the fee, we sue them. Our experience in this area has been very good, with only one countersuit for malpractice in the last five years. Of course, every case is determined on an individual basis, but the general policy is to refer to Small Claims Court or file a suit.

Similarly, information regarding each partner's attainment of goals set by the partnership in the areas of practice development, new contacts, goodwill meetings, and new business should be monitored regularly by the managing partner. It is his responsibility to assist the partners so that they achieve their respective goals.

Every CPA firm should have accrual-basis financial statements prepared each month, with comparisons to monthly budgets. Financial goals should be set and adhered to.

We have also developed staff utilization teams for the express purpose of monitoring the effective utilization of staff. Each team meets once a month and consists of a team captain and four members. The team captains make certain that staff members meet their chargeable, practice development, and administrative goals.

Planning

I'm a strong believer in developing an annual strategic plan. The strategic plan should consist of financial projections, allocation of time by partners and staff, and a well thought-out marketing plan. Our annual strategic plan is developed prior to our retreat, which takes place in December of each year. The purpose of the retreat is to go through all of the details of the annual strategic plan and secure the approval of all partners. All partners must approve each other's time goals, practice development, and administrative goals. We make every effort to see that the retreat always is a positive experience inasmuch as it is the take-off meeting for the coming year, and we want to move forward with a positive attitude.

Partner compensation is never discussed at the retreat. Salary and compensation issues are always resolved beforehand.

Leadership

Don't believe in the myth of democracy if you want a well-run practice. Accounting firms should not be run by committee. Committees should only establish policies. Firms should be run by a strong managing partner responsible to the partners as a group.

Leadership ability is the most important quality managing partners can have. They must be tenacious, able and willing to fight for their beliefs, and should provide vision and direction to their firms.

Managing partners need power to get things done and move the firm in the direction established by the partnership. Organizing a bonus pool might be a good idea so that the managing partner is in a position to encourage and reward partner productivity.

He or she will need a proper system for monitoring financial results, engage in long- and short-range planning, and must be market-oriented and market-driven. Without this type of leadership, the concept of marketing may die, and along with it the growth of the firm.

Community and political involvement is essential. More than anything, though, the managing partner should always maintain a positive attitude. This is the only way he or she will be able to lead the firm in the desired direction. ☑

—by Harvey A. Goldstein, CPA
Los Angeles, California

PERFORMANCE STANDARDS FOR SUCCESS

November 1981

Do you think your firm is growing faster than other CPA firms in your area? Are you sure of your answer? It is too easy to be misled by deceptive measures of growth and productivity. Increased activity is not necessarily progress and adding people to the payroll does not necessarily mean growth.

In order to appraise your firm's comparative performance, as well as its actual health and vitality, you need specific financial standards. You need to be able to compare, say, the rate of growth in chargeable hours to the rate of growth in fee revenue to see how your firm stacks up. You need records to be able to see whether the firm is being managed well and if it has the capability of doing better. In short, you need good reports to get good results.

The maintenance of financial standards and compliance with professional standards can be expensive. Peer reviews, for example, cost about 1 percent of revenues. No doubt, you probably could make more money for a while if you cut a few corners here and there. But such action could jeopardize your firm's reputation, even survival, over time. Besides, there are definite benefits to be derived from having specified standards.

To begin with, you can nearly always achieve better-than-average results if you set objectives. These goals should be definable, attainable and measurable. Reporting is the beginning of control because you obviously can't control the performance if you don't know what the performance is. You should know the chargeable hours monthly, or even more frequently, of everyone in the firm. Peer pressure will make people strive to achieve the standards.

In order to set performance standards, you will need some financial ratios with which to compare your firm's current statistics and to help you set objectives. In this regard, you might find that the surveys made of participants at management of an accounting practice conferences yield useful statistics as do the surveys made by several state societies (see "Practice Management Profile" in the June issue).

You can get a perspective on your firm through these ratios if the measurements are continuous and comparable. For example, we determine how many people our firm needs by dividing total hours by 2,300 (the average total hours per staff member). You can find out other things about your firm such as its having too many partners for the fees produced (or that partners are not doing partner work) or that there are too many expensive people for the fees generated. In this case, either the fees should be increased or the staff reduced. You can also determine if the ratio of support staff to professional staff is too high. (Support staff should account for roughly 6 percent of fees.)

Some firms tend to make people partners for the wrong reasons and in reality only a limited number of accountants are worth the price. Still, sometimes firms don't have enough partners. This may be more profitable in the short run but over time, quality will suffer. So, take a look at the number of staff people, the fee income and the billable hours per partner. (The firm should produce 6,200 to 7,000 billable hours per partner.) Two other areas that should be looked into are the average net profit per partner and methods of distributing profit. The previously mentioned surveys and the AICPA's *Management of an Accounting Practice Handbook* can be of help here.

Staff accountants represent the greatest cost and the greatest opportunity to the firm in producing billable hours. You should reasonably expect 1,600 to 1,800 billable hours and annual fees in the region of $60,000 to $75,000 per staff accountant. The profit potential lies in partner supervision of staff accountants' efforts and in the sale of more billable hours. This takes planning and organization.

The support staff is an unappreciated resource in most firms. It is well worthwhile to take a broader view of people's capabilities and to organize the support functions better. (Those crash jobs just cost the firm more.) The statistics to aim for are revenues of $125,000 to $225,000 and 400 to 600 chargeable hours per support staff person. You should keep in mind too that, in the future, the support staff will need increased skills in order to operate the more sophisticated office equipment that will be available. It is essential to get the staff's cooperation and participation if your reorganizational efforts are to be successful.

Generally speaking, the reasons for the disparities in the ratios between the most profitable firms and others (see "Practice Management Profile" in the June issue) is that the most profitable firms in all size categories have more staff per partner and more billable hours per partner. Most firms average 1,200 to 1,300 billable hours per partner but the most profitable firms have about 150 hours more and 40 to 50 percent greater partner income.

In the management of engagements, partners must be accountable to the firm as well as to clients. A partner must get an engagement at a rate that is right for the firm. Not only should a partner be responsible for billing the firm's standard rates and reviewing them frequently, but also for making sure that they are realized. Many firms only realize at about the rate they pay three- to five-year seniors. (Thirty dollars per hour is a good average.) Partners are also responsible for the condition of work-in-process—for seeing that expensive engagements are billed and collected with dispatch—and for accounts receivable.

Staff management is of growing importance nowadays and the managing partner must devote sufficient time to this job, if the firm is to achieve the standards set. And other partners must be supportive over such things as hiring enough staff members, paying attention to billed and unbilled services, being aware of needed changes in the type of services offered and of the need to update office equipment. With established standards to aid in the setting of goals and a staff that is motivated to attain them, your firm's performance should indeed be better-than-average.

–by James M. Arnett, CPA
Charleston, West Virginia

HOW TO IMPROVE YOUR BOTTOM LINE

May 1989

For several years now there has been an ongoing series of events, both inside and outside the profession, that affect firms' financial results. Despite current difficulties, I believe the future is extremely bright for local firms. At Metcalf, Zima & Company, we have developed a long-range plan that projects what our firm will be doing in the year 2000. We believe that conditions in the years ahead will provide opportunities to bring new services to local practices. What we local practitioners have to do, though, is examine our whole fee-generating process and turn these opportunities into bottom-line results.

What does it take to make more profit?

The initial step in improving firm profitability is to look at your service potential. To do this, I suggest you use the T-account (the accounting equation) approach. It is a simple system, but one that works.

First, list as assets all of the services you are currently providing. Then, find out what services other practitioners in your service area are selling. List as a liability any service that you are not providing. You then want to see if you can develop any of these services in your own firm. If you can turn the liabilities into assets, the net result is equity.

You need talent in the firm in order to develop new services. Personnel can be evaluated using the same T-account method. List people's positive characteristics and abilities as assets and their weaknesses as liabilities. (The knowledge and skill form in section 307.02 of the AICPA *MAP Handbook* can be helpful in this regard.) Work on eliminating the liabilities. Help your staff to improve. Create personal equity for all staff members, and their talent will help you grow.

Small firms might consider developing niches and specialties. One promising area, I believe, is servicing the legal profession.

At Metcalf, Zima & Company, we subscribe to a program called Services to the Legal Profession, which is a service provided by Hudson Sawyer. We are provided with a quarterly newsletter, the *Law Management Journal,* which we send to law firms. The program also provides marketing brochures, and a six-part course on law firm management that our staff presents to law firms. We were also trained in legal profession issues as part of the package.

The new business we are seeing from this program convinces us that we made the best decision. The opportunities are immense. We are becoming heavily involved in litigation support and expert testimony and we are expanding our tax practice with the growth in the legal niche. The referrals which come from attorneys lead to more profitable work, and we find that our staff enjoys the reputation as *the* CPA firm serving attorneys in Atlanta. The firms subscribing to this program in other cities are experiencing the same success.

There are two other areas where involvement can be beneficial—in state society activities and in your local community. It is important to stay current regarding professional issues. Serving on state society committees keeps you informed about professional developments and also gives your firm visibility.

Think politically. Assume a leadership role in community affairs. We CPAs are trained to analyze and solve problems. If things aren't going right in your community, it provides you with a tremendous opportunity to offer help and become known. Become campaign chairman for a charitable organization, for example. It will open doors for you and can lead to your making a significant number of contacts.

Budgeting and planning

Manage your practice from the bottom line up. That is, determine the bottom-line results you want, and budget accordingly. When drawing up a long-range plan, it is sometimes difficult to get all partners to understand what you are trying to achieve. They might not like some of the interim results. A better way to budget is to have partners determine what they want to earn, and then determine the chargeable hours needed at the realization rate you can expect—that's your net fee goal.

Long-range planning is more than a numbers process, however. It involves many steps, among which the most important is identifying the firm's purpose—its philosophy. You must decide what you want the firm to be.

As part of our long-range plan for the year 2000, we have a picture in front of us of the volume we will be doing, the annual percentage increase in chargeable hours that this will require, and the number of partners in the firm and what their average income will be. We also have a picture of the makeup of our staff and the type of facility we will own. Probably 60 percent of the staff will be women, and we envision having a day-care center so that we can attract and retain top talent in our firm.

In short, write down what you want your firm to be five to ten years in the future, and put a picture in front of your partners. Create a profile of the firm you want. The numbers, then, are easy.

Regarding the firm's financial and organizational structure, think cash. Measure your successes and failures in cash. Determine where you are making money and where you are not. And don't give one person the sole responsibility for managing the firm. By all means, have a managing partner, but also have a management committee. If you are a sole practitioner, get an outsider, such as a banker, involved. (You and the banker can be an advisory board.) You need a balance in every firm.

Broadcast your plan. Involve all members of the firm in it. If you let people know what your plan is, they will help you achieve it. Go over the financial results with the staff. If you are a sole proprietor, go over the results with an outside advisor.

You can also use your long-range plan when recruiting. Give your plan and financial results to the accounting professors at one or two schools. Let them know what you are trying to accomplish. Show them that you can offer opportunities, and encourage them to send you talented students. Don't pass up recruiting as a means of building. It is expensive, but it is also an investment in the future.

Several state societies have "résumé banks" of trained staff, for both the use of member firms and their clients who are looking for controllers. It is also well worth considering part-time paraprofessionals. We have found them to be most productive, very profitable, and businesslike. The staff in our client write-up department, for example, has a realization rate of over 100 percent. Administrative personnel are important to firms. Tell them about your plans. They need to be inspired, too.

Expense control

Our largest and most manageable expense is people. We need to increase staff members' utilization rates. Delegate more, instruct better, and set a good example. If we do that, we will find that their realization rates can increase, too.

Utilization involves weeding out clients who don't suit your practice. You can spend a lot of time with clients who are not profitable for your firm. Such clients may pay poorly; that is, they may pay late or argue about fees, they may have low realization rates, or their work may expose you to risks without rewards.

Most often, your staff's time can be better spent. By decreasing your people cost, your staff becomes more vital to your success. In summary, I believe in the future of public accounting. We just have to make sure we are making money at what we are doing. ☑

—*by* **Donald P. Zima, CPA,** *Metcalf, Zima & Company, 1700 Peachtree Summit, 401 West Peachtree Street, Atlanta, Georgia 30308*

WHY BUDGET

November 1977

Budgeting forces a CPA firm to plan and make decisions on the type and size of clients it wants, the staff needed, and what it should pay them.

It helps to control operations by permitting at least monthly comparisons of actual results with financial goals. Deviations are quickly spotted and corrected.

The financial effects of alternative courses of action such as changes in partners' duties, or the loss of clients, hiring extra staff, etc., are more easily determined.

Large write-downs at the end of the month, and other unpleasant surprises, can be avoided by means of a weekly report of work in process for larger engagements.

Budgeting permits more effective control and increases motivation of employees. Professional staff are usually interested in personal development and the firm's growth. Management must be willing to encourage this by paying for professional development, and by having the personnel available to service new clients. Also, salaries must be competitive. These decisions will all impact the budget because they necessitate the use of professional-level billing rates.

A little more time spent in planning how to achieve goals will result in a lot less effort needed to attain them.

- ☐ Start simply. If you attempt an elaborate system to begin with, you may never get it operational.
- ☐ Make your goals realistic. Set them at a level that will require a reasonable amount of stretching and effort to achieve, but always at an attainable level.
- ☐ Adopt one major improvement annually so that your system is refined gradually.
- ☐ Get your subordinates deeply involved. Let them help develop plans and take corrective action when necessary. They should develop formal systems for setting goals and be motivated to attain them.
- ☐ Keep your plan flexible. Be prepared to revise your budget for major changes such as the loss of one or two large clients, or the hiring of additional staff.

The managing partner should think of his firm as his number one client, and his partners must allow him enough time to do this. Sole practitioners can adopt this principle too. During the seven years that I was a sole practitioner, my goal was to have at least 50% nonchargeable time to be used for administrative projects, and for professional and practice development.

The key to a CPA firm's profitability lies in attaining budgeted revenue. Because revenue can vary significantly each day, depending on how efficiently we operate, our firm developed both weekly and monthly reports to help us realize our projections. These reports concentrate on three distinct elements: chargeable hours, standard billing rates, and write-downs from these rates.

To save their time, partners need only determine the variable budget information such as salaries and projected billing rates. You may then have your clerical staff make the necessary computations.

Our experience over the past two years has shown the tremendous value of having adequate partner time available for public relations and administrative duties. This was pre-determined through projections which showed that partners should limit their chargeable hours primarily to planning engagements, training staff, reviewing workpapers, and meeting clients.

The major portion of a firm's success is due to the efforts devoted to planning and controlling operations. They help keep a firm's billing rates competitive, yet provide enough revenue for the salaries and training that will attract and motivate professional staff.

CPAs will often recommend to clients that they institute a budgeting system to increase their profits. By using budgets in their own firms they will obtain firsthand experience.

Delay in budgeting is costing your firm money. Now is the time to get started with a basic budgeting system. Refinements can be added later.

—by Jerry S. Huss,
Wauwatosa, Wisconsin

IS PROFIT PLANNING NECESSARY?

February 1982

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

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

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

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

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

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

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

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

SERVICE IS THE KEY TO THE BOTTOM LINE

October 1988

Profits are one measurement of a CPA firm's success. Profitability can be fleeting, however. As a small firm grows, clients tend to receive less partner attention because service responsibilities are shifted more and more to staff. Profits can only keep growing, though, if service remains the focal point of the client relationship.

At Serotta, Maddocks & Devanny, we define service as providing timely, professional, and technically accurate work for our clients. More than this, though, we define service as providing client-expected value relative to quality. We believe we can affect client perceptions through an educational process and by proper presentation of our work. Furthermore, we think that a commitment to service will have a positive effect on the bottom line of our firm, but that the firm must first be structured to be able to deliver its work within that commitment.

Commitment is a team effort. Our commitment, therefore, starts with an indoctrination of staff members. We define our service expectations and communicate these expectations and the methods for obtaining our goals to staff. We hold weekly technical meetings and strategic retreats as well as use outside CPE programs to develop the skills to meet our service goals. We realize that no CPA firm can deliver timely service if it does not have enough employees and, therefore, analyze our staff needs three or four times a year and hire accordingly.

To emphasize our commitment to service, we have instituted a year-end planning meeting at which we schedule the target due date of each engagement, with interim date checks provided for longer engagements. In addition, we require target due date extensions to be submitted to the partner-in-charge, with a detailed reason for each extension. We also review the previous year's engagement for ideas on quality improvements, suggestions for additional services, and tax and financial planning ideas. The discussions at this meeting alert staff to anticipated problems and provide solutions to them.

Two client meetings emphasize value of services

Clients must be educated to perceive that they are receiving valuable services. To achieve this goal, we schedule two meetings with each client. At the first, the client is informed of the services to be performed and of the fees to be charged for these services. This meeting has a typed agenda that always includes tax-planning suggestions for the client's business and key personnel. Goals and decisions to be made about the engagement are outlined.

The second meeting is for delivery of the product. This meeting would include a professional presentation and a discussion of the goals achieved. Items on this achievements list could be the taxes we had saved, how we had delivered the product by the agreed date, or an explanation of an unqualified audit opinion and how the client had earned it. We believe in explaining financial statements to clients. We tell them how we think their bankers will react to their financials, and whether or not this would be a good time to apply for more credit. This helps our clients forge closer relationships with their bankers.

We even have a similar procedure for individual tax returns. Many CPAs mail completed tax returns to their clients. We meet with clients to explain the balance due, or to "smile" with them over the refund. We also discuss some aspect of the return. We find that a five- to fifteen-minute conference with a tax client achieves our goal of having the client perceive value in the service.

We also find that happy clients pay their bills on time and tell their friends and associates about us—their CPA firm. More referrals mean increased revenue from "good clients," and demonstrate that service is indeed the key to the bottom line. ☑

—by **Abram J. Serotta, CPA,** *Serotta, Maddocks & Devanny, 1261 Green Street, Augusta, Georgia 30901*

EFFECTIVE MANAGEMENT IN A SMALL FIRM

January 1983

Do you ever stop to think about your firm and where you are going? For example, do you look at your firm's strengths and weaknesses and ask yourself why clients should stay with you or whether you should go out and get new clients? Are you doing what you want to do? Do you know where you want to be five years from now? How you practice and for whom you practice reflect on how people view your firm. To build a quality practice, you must have goals and objectives, and more than anything else, you need effective management.

About ten years ago, I wrote a Practitioners Forum article on practice development. The gist of the article was that the key to developing and upgrading our practices was, and still is, the "forgotten client."

We all have clients who are owner/managers of businesses for whom we perform write-ups, financial statements and tax work, etc.—services oriented to third parties such as the government or banks. However, we neglect the real needs of this type of client. What we should do is learn about the

Effective Small Firm Management

Management Skills

☐ *Management*

1. The accomplishment of an objective through human effort.

☐ *Setting of objectives*

1. Must be measurable—How will I know when I get there?
2. Must have an established time frame—When is it to be accomplished?

☐ *Planning*

1. Development of the game plan.
2. How are we going to reach the objective?

☐ *Organizing*

1. Determine the necessary activities.
2. Establish the necessary authority, responsibility, and accountability.
3. Allocate the available resources—money, manpower, time, and facilities.

☐ *Motivating and communicating*

1. Communicate the objective and the necessary information for effective action.
2. Communicate upwards, downwards, and laterally so all efforts can be coordinated and integrated.
3. Develop a team.
4. Get individuals to subordinate personal desires for the good of the group.

☐ *Controlling and measuring*

1. Establish yardsticks.
2. Establish early warning systems of potential failures.
3. Analyze and evaluate performance:
   a. How effective was the team?
   b. How efficiently did we use the resources?
4. Follow-up is the key to effective control.
5. Communication is the key to effective measurement.

Putting It All Together

The firm's plan of action.

Conclusion

A major factor in the excellence of professional work and the adherence to the ethics and standards of our profession is high quality, firm management and administration.

clients' businesses and how to identify what they need to know to run their businesses better. We should also learn how to communicate with these clients using their terms.

In the article, I pointed out that many CPA firms are where they are today not because of their direction and leadership but because someone called with a request for a particular service. If we are not to continue drifting this way and that at the behest of our clients, we must have some firm objectives regarding the nature of the practices we want to develop. We must employ some effective management techniques that will help make these objectives realizable.

There is no doubt that the environment in which we operate our practices will continue to change over the next 5 to 10 years. These environmental changes will exacerbate the organizational changes that firms undergo as they grow. (See "Evolution and Revolution as Accounting Firms Grow" in the October 1973 Practitioners Forum and "The Prerequisites for Practice Growth" in the December 1977 issue of the *CPA Practitioner.*)

To cope with these various changes, firms must be structured in ways that not only provide solutions to current problems but are also suited for the next growth phase. This requires an awareness of where the firm is in its growth pattern and of the type of management structure needed for the next stage; it also requires skills in the areas of communication, motivation, supervision, evaluation and marketing.

If you are to build the type of practice you want, you must be able to attract, train and retain competent personnel who have or can develop the necessary expertise. You must be able to harmonize their needs, goals and desires with the firm's objectives. As always, it is essential to keep people informed of your plans and to let them know what is expected of them.

In our firm, we set personnel policies around a concept we developed called "Career Path." In order to competently perform the work required in a quality practice, staff must be able to master the required technical skills. Basically, in our firm, staff accountants are evaluated as to their knowledge of the following areas:

- ☐ Workpaper preparation/review.
- ☐ Accounting theory/practice.
- ☐ Auditing theory/procedures.
- ☐ Federal and state taxes.
- ☐ Accounting systems.

They are also evaluated on their abilities to apply this knowledge to client problems and to recognize client needs, i.e., their practice development skills.

Public accounting is a people business—we sell our people's services. This necessitates that considerable time and effort be put into training, supervising and evaluating staff. Account administrators must also have the personnel skills to

- ☐ Supervise the work of others;
- ☐ Communicate with superiors, subordinates and clients;
- ☐ Train and develop subordinates;

and they must have proficiency in practice development to solve client problems.

Once you start having people work for you, you are in a management situation. In any firm, somebody has to manage. If the skills aren't there, they must be acquired at CPE courses, etc. Management tasks include the following:

- ☐ Planning.
- ☐ Organizing.
- ☐ Motivating.
- ☐ Controlling.

Also at this level, practice growth requirements include the capability to acquire, develop and retain clients.

Specialization in some form or another (probably in an industry rather than in, say, tax or audit) seems to offer the best chance for the survival of small CPA firms. To specialize effectively, you should

- ☐ Take on new clients only if they desire or are potentially suited for the type of service you want to provide.
- ☐ Begin to cull out present clients who are not compatible with your objectives as new, suitable clients are developed.
- ☐ Emphasize your capacity to help present or prospective clients use financial information for more profitable, efficient operations.

If you are thinking of participating in a group practice, or even if you are already involved with one, ask yourself why it is better than practicing on your own. If you can't think of any good reasons, perhaps your firm is not a single entity. Many small firms are like that. They are not really firms at all—the partners merely share offices and staff. His firm/my firm operations are very difficult to manage, and they find it hard to attract and keep good staff and clients.

A firm operating as a single entity functions as a team does. It is not only manageable but can be managed well. Areas of responsibility and accountability are clearly defined and work can be adequately reviewed. Partners have at least one specific area of firm-wide responsibility and are accountable to the firm for it. Firms must have this type of responsibility and accountability. They also need someone with authority—a managing partner with the power to make decisions. The source of this authority should be the firm's partnership agreement.

When a firm operates as a single entity—with overall policies, etc.—it is easier for staff people to integrate their goals with the firm's objectives; and it then becomes easier for the firm to attract the type of people it wants. The net result of this type of management is that it allows you to develop a practice you know will survive and grow in the years ahead—one that can offer its clients effective, high-quality and efficient service.

—by Robert K. Whipple, CPA
Indianapolis, Indiana

KEEPING THE FIRM PROFITABLE IN TURBULENT TIMES

December 1982

A popular session at the recent AICPA annual meeting was a panel discussion by members of the management of an accounting practice committee that dealt with the maintenance of firm profits in a difficult economic climate. According to Jerrell A. Atkinson, the moderator, the five basic areas that cause turbulence in a practice are inflation, salaries, the fee structure and client acceptance of it, collection of fees and competition from other firms. Mr. Atkinson remarked that the profitability of a firm can eliminate about 50 percent of these problems. With Mr. Atkinson on the panel were Howard I. Bernstein, Robert F. Warwick and Erwin Bud Wittus. Here are some of their comments.

Warwick

The maintenance of profits requires the effective utilization of the firm's resources—the time and skills of its people. Efforts to increase this productivity are hampered by the need to maintain high standards of quality and by CPE requirements, which in our firm average 100 man-hours per year (up from 25 hours a few years ago) and by the need to have the right people in the right place at the right time. Increasing productivity, therefore, requires careful budgeting, scheduling and follow-up. If not done properly, staff morale suffers and good client services and relationships are jeopardized.

In our firm, we believe in long-term scheduling (one year, updated each quarter) as well as preparing a budget for every engagement. Our system begins with a projection of the number of hours we expect to charge a client during the twelve months following the date of the budget. These budgets include hours broken down by months, staff classifications and, if possible, staff names. This information is submitted to the scheduling partner by the partner in charge of a particular client at the beginning of each quarter. The scheduling partner reviews the information as it relates to the firm's overall quality control objectives regarding staff abilities, firmwide workloads, individual career patterns, independence, etc. Any changes made are reported to the submitting partner, and any unresolved differences of opinion are referred to the managing partner for a final decision. We budget 75 percent of the following chargeable hour standards:

☐ Staff accountant	1800 hours
☐ Senior accountant	1800 hours
☐ Supervisors	1600 hours
☐ Managers	1600 hours
☐ Partners	1200 hours

Our system is monitored by the firm administrator and a clerical staff person, with one partner being responsible for it. Although we know that it is not perfect, we believe that our system of having an annual schedule for each professional with the hours budgeted by month, and a current schedule of actual assignments in process provides scheduling partners (in each office) with a tool to maximize the utilization of staff skills. It reduces staff uncertainty over schedules and last minute scheduling changes and makes it easier to monitor individuals for a variety of engagements.

Wittus

Setting fees is a difficult art. You must not only be able to cover your expenses and attract the staff and partners you want but you must also earn an adequate return on your investment.

In our firm, billings are pretty much divided between hourly charges and fixed fees. While the quality of service is the same whether it is on a fixed fee or per diem basis, fixed fees do have some advantages in that they are easier to sell and bill. They also make it easier to look at the engagement in terms of its profitability.

In this regard, we examine our cost system with respect to fixed fees twice a year to see how both firm and client are doing and to determine how long it has been since the last adjustment.

Per diem rates are based on 3 to 3½ times compensation rate, with estate work and special services commanding higher figures. Rates are designed to build in ordinary expenses and we bill odd amounts. We find the odd numbers are inclined to be more acceptable than if we rounded them off.

Collection problems often increase during times of economic difficulty, and we suffer more write-downs and tend to carry extended receivables. Charging retainers or getting fees in advance can minimize the problem as can imposing a service charge on receivables (which more firms are doing). One suggestion is to go over time records with clients or even to cut off services to the really tardy ones. We have even been known to take a client to the bank to arrange a loan in an effort to get quicker payment. Suing for fees? Well, we have on occasion, but first consider the time and effort involved and the possible negative effect this might have.

Bernstein

Two major management information systems are needed in a CPA firm—one for management of the firm itself and the other to manage the delivery of services to clients. Modern computers can supply more information than anyone cares to have, so a system is required that provides brief reports on truly important matters backed up by availability of detailed reports.

In the management of a CPA firm, the truly important matters are production, realization, collection and payroll expenses. The firm needs (usually monthly) the information shown below.

The Important Matter	*The Brief Report*	*The Detailed Backup Data*
Production	Firm productivity analysis	Production by individual
	Firm actual production vs. production goals	Individual production vs. production goals
	Weekly time available report and monthly schedule	Year ahead schedule
	Partner chargeable time report	
Realization	Firm actual realization vs. goal Partner actual realization vs. goal	Realization by client within partner
Collection	WIP—aged one line for each partner	WIP—aged by client within partner
	Accounts receivable—aged one line for each partner	Accounts receivable—aged by client within partner
	Weekly accounts receivable hot list	
	Weekly report on accounts receivable collection action	
Payroll expense	See all production reports above	
	Payroll dollars as percent of produced values	Salary spreadsheet—individuals within months

THE FIRST STEP IN PRACTICE IMPROVEMENT

July 1983

Practice improvement is a consideration we all face no matter how large or successful our firms become. There is always one area or another that requires attention as we constantly seek to upgrade quality, productivity, fees, profits and the professional environment of our partners and staff.

Many attempts at improvement fail or require an inordinate amount of energy to implement. The reasons are not always clear but difficulties can often be traced to resistance to change—any change. The problem is that few significant improvements can be achieved without change.

In order to realize improvements in our practices, we should ask ourselves three basic questions:

- ☐ Where are we now?
- ☐ Where do we want to go?
- ☐ How do we plan to get there?

Too often, we leap from the first question and begin attempting improvement by defining where we want to go and what it will take to get there. Failure to clearly define a starting point will doom any improvement project. In many cases, the best first step is not to look forward to where we want to go but back to see where we have been.

Often, there can be found in the history of the partners' relationships the substance of their difficulties in making changes or achieving new goals. Many firms suffer from birth defects. They were conceived for the wrong reasons. If the conceptual error is not understood, it can be a serious obstacle to positive change.

The history of many firms goes something like this. Mr. Taft, after gaining experience with a local firm, started his own practice with very few clients. He worked hard and built a stable practice which supported his family. However, Mr. Taft soon reached capacity in terms of hours available and compensated by devoting less time to his family and, apart from CPE on taxes, less time to reading and keeping up-to-date. Recognizing that he was not keeping current, he felt unjustified in increasing his fees.

Mr. Taft's solution was to find Mr. Cooper, who was experiencing the same problems, and they jointly established the firm of Taft and Cooper. The immediate bottom line improvement was significant but while symptoms were treated, the real problems of the partners were in no way solved. In fact, the two men continued on a parallel course with exactly the same set of problems as before, the only difference being that they now had adjoining offices.

In time, Mr. Taft and Mr. Cooper realized that they had continuing problems, but again, they treated only the symptoms and took in a young person whose prior experience was with a large national firm. The result was frustration for all because Mr. Taft and Mr. Cooper were interested in changing things, not in changing themselves, while the newcomer not only lacked perception of the real problems but also was not in tune with the realities of public accounting at the local firm level.

What Mr. Taft and Mr. Cooper failed to realize was that they had never created a true firm and that any attempt at improvement was destined for failure because it would be based upon an invalid starting point. Because the two of them had never integrated their professional lives or coordinated their activities, they had never truly worked together to offer comprehensive services and could not build a team having such capabilities. A team can't have multiple head coaches; it must have an integrated focus on shared goals. In order to make the changes needed, Messrs. Taft and Cooper must build a true firm—a team. But before they can do that, they must first change themselves.

A team cannot be created by just adding individuals. Cooperation and a commitment to the team concept is required from each member of the firm. The catch is that integrating personal goals with team goals is a complex adjustment and can be risky. In fact, it may not be possible or desirable for some people to make that change.

When you take a realistic look at where you are now and recognize that dramatic change might result in casualties, you may very well decide that where you are now is not so bad after all. If you still want to go after new accomplishments, then you have a new road to travel.

Moving toward practice improvement requires a thorough examination of the past and an understanding of the unwritten rules that govern partner relationships. Those rules, once recognized, may prove unworkable at the new business of functioning as a full-service firm.

In reality, the first step to practice improvement is the joining of the partners into a team. It includes setting standards, working together, coordinating assignments and sharing knowledge and clients. Above all, though, it means making a genuine commitment of all your resources to the team.

—by Fred Withum, CPA
Princeton, New Jersey

SURVIVAL AND SUCCESS STRATEGIES (PART I)

November 1988

In April this year, our firm held a roundtable attended by some of the leading consultants to the accounting profession. Moderated by Irwin Friedman, managing partner of our parent firm, the group discussed myriad topics related to helping firms survive and prosper in the years ahead. Let's look at some of the ideas and suggestions.

The role of strong management

To meet the demands imposed by a changing marketplace, practitioners need to arm themselves with new marketing and management techniques. In fact, one answer to meeting the challenges may be in the area of firm management. Firms need to be able to attract and compensate first-rate talent, and offer the range of services demanded by their clients. In many instances, growth guided by strong management will be a viable strategy for success.

There are a number of routes to success in public accounting, but without a commitment to proper management, it is unlikely that a firm will prosper in the future. Someone with the requisite talent and dedication will need to accept responsibility for the firm's direction, for motivating others to optimum performance, and for implementing strategies, whether the firm is a boutique or provides a full range of services. Firms need a strategic vision and an effective way to implement strategies and achieve goals.

Many firms regard personal billable hours as the key criterion in determining compensation. However, a review of large and small firms that are no longer in operation showed that, typically, the managing partner (or management team) emphasized production, that is, billable hours, while essentially ignoring marketing (practice development) and management. Firms that have survived found that there are three ingredients to a successful practice—quality service, innovative marketing, and good management. When one is missing, the practice is incomplete.

The role of niche marketing

One option for local firms is to select a market niche, focus on it, and then stay with it for the long haul. A niche can either be a functional one such as mergers and acquisitions, or risk management, or an industry specialty such as real estate or health care.

A functional niche is an excellent way for firms to get a foot in the door of a potential client. It is difficult to build or sustain a practice concentrating on just this specialty, though. And firms that engage in industry niche marketing, or intend to follow this course, should have either identified a market need or developed a reputation for expertise in a particular specialty.

There is a familiar phrase that is worth bearing in mind: "Perception gets clients, reality keeps them." Firms quite often have the reality, that is, the resources needed for serving a particular niche. They just don't know how to communicate the perception. On the other hand, firms that have developed successful niche marketing techniques find that being perceived as unique or better than their competition can provide them with a route to long-term viability and profitability.

The need for firm profitability

Clients are demanding much more of their CPA than just the traditional roles of auditor and tax return preparer. Given the anticipated change in the Institute's ban on commissions and contingent fees, and the far-reaching impact this could have on firm profitability, and also the profession's ability to attract and retain talented people, the consultants recommend that part of a firm's long-range planning might consider what services could be offered on a contingent-fee basis, and how they might be marketed.

The consultants also discussed value billing. For example, if the time spent on an engagement amounts to $5,000 based on standard hourly rates, but the work saved the client $100,000, what would you bill?

Many firms would be satisfied billing $5,000. That is not necessarily the right approach, however, for a firm looking to optimize its income. But often there is a reluctance to value bill. Sometimes this is because of firm philosophy, and sometimes simply due to lack of training in value billing techniques.

It is incumbent upon management to get partners and staff to accept value billing. This can be accomplished by getting them more involved in the billing process. Convincing clients is more important than convincing partners and staff, though. The key to getting more than just an hourly rate is to show clients the value of the services rendered. Delivering the product or recommendation in person and emphasizing the benefits or bottom-line results is a good way to do this.

Capturing expenses

To improve profitability, firms are looking at ways to recapture some of the costs of doing business. There are some costs, for example, that can be passed on to a client because they would not have been incurred except for the work being done for that client. This might include costs for word processing, photocopies, facsimiles, deliveries, records storage, postage, office supplies, and for overtime pay necessary to complete an engagement on time. Some firms are even passing on to clients a percentage of their liability insurance premium and charging clients interest on unpaid balances.

Again, don't just prepare the bill and mail it to the client. You may find it appropriate to discuss various items with the client and explain the value of services received.

Client service

One of the major challenges facing CPA firms in the next decade is to get partners and staff to put themselves in the client's shoes and to think as a client would about the quality of service received. For example, partners are often reluctant to

- ☐ Discuss up front with a client how much a service is going to cost.
- ☐ Keep accurate track of where the time was actually spent, and evaluate if the client received value for that time.
- ☐ Set a date for the completion of the engagement.
- ☐ Inform the client if the project will not be completed on time.

To remedy this, firms might consider appointing a client-service review director or a client service partner. The position would be comparable to that of the quality control reviewer except that the goal would be to make sure the clients received the quality of service they wanted and were satisfied with the firm.

Many of the consultants are also advising firms to conduct client satisfaction surveys to provide feedback as to how clients are rating the services they are currently using. Properly constructed, such surveys can be helpful and can also be an effective marketing tool.

Golden era ahead for the local firm

The consultants believe that competitive, business, and professional developments favor the well-run local firm in coming years. This will result in a rise in financial rewards, increased job satisfaction, and a drastic reduction in stress for the local practitioner. A close geographic relationship and the personal contact between the principals of the CPA firm and the principals of the client help the local firm better serve its clients and make it unique. ☑

—by **Allan D. Koltin, CPA,** *Practice Development Institute (PDI), 401 North Michigan Avenue, Chicago, Illinois 60611-4240, tel. (800) 227-0498; in Illinois, (312) 661-0300*

Section 11

MANAGING GROWTH

THE ORGANIZATIONAL PROBLEMS OF RAPID GROWTH

November 1983

The beginning of our rapid growth really began in 1970 when four of us got together to form a firm with annual revenues of about $200,000. We came from disparate backgrounds and held no common approach to the problems of firm management. Still, we dreamed of creating a larger firm, and increasing the number of employees seemed logical.

At that time, our idea of a larger firm was one of 20 people in total, conceptually 25, but certainly no more than 50. Today, we find ourselves with approximately eighty people in the firm. Between 1976 and today, we have grown from 12 people to our present level. We have gone through the addition of partners by merger, acquisition and internal promotion, and have lost partners through separation and death to the point where we now have seven partners in the firm. In this highly compressed time period, we have experienced both the pros and cons of rapid growth.

In the early 1970s, I would attend conferences and listen to speakers proclaiming the values of specialization and departmentalization and wonder how they related to our firm. Now, 10 years later, we find ourselves going through these same processes. In particular, we have developed expertise in the servicing of small- to medium-size businesses and real estate ventures. We have established quality control, scheduling, tax, real estate and syndication departments and continue to anticipate the need for further departmentalization.

In the business world, natural evolution has progressed from individual entrepreneurs, through the formation of guilds and trade associations in which individuals perform their own tasks yet join together for the natural benefits of shared knowledge and resources, to the higher level of the corporate entity. A corporation has an organizational structure which enables it to function in a manner that provides for self-perpetuation and a clear delineation of responsibilities.

Many managers of service businesses, particularly accounting professionals, see themselves as still functioning in a guild environment. Yet, professional service organizations bring a variety of skills to the resolution of client problems, and it is the managers' task to effectively weld these skills together so that the clients benefit to the fullest extent possible. This suggests a need to think corporate—i.e. to think of our public accounting practices and their needs and problems the same way we define and address the needs and problems of growth-oriented manufacturing clients. The problems of any company that is in a period of rapid growth can usually be characterized in the following broad areas—financial controls, quality control and the optimal use of productive resources.

Financial controls

When it comes to evaluating our own operations, we have for some reason become acculturated to looking at what we individually draw. When we get past that point and begin to look at the actual business, we tend to look at the earnings of the firm after draws or at the average earnings per partner. That these evaluative approaches are misleading becomes obvious when we compare them to the ways we analyze a corporate entity.

We don't look at a corporation in terms of officers' salaries; we look at its earnings. A corporation's earnings are often reflected in the buildup of accounts receivable and inventory, which we would say are analogous to our accounts receivable and work in process. We would never tell a client that inventory and accounts receivable don't count and, similarly, we should consider the collectibility and realization of work in process and accounts receivable when attempting to evaluate the economic efficiencies of our own organizations. In the same vein, in order to properly evaluate a business entity, we wouldn't be satisfied with earnings before officers' salaries to arrive at the true results.

In the management of our firms, we tend to mix together reasonable compensation for services provided—salary, and the return on our entrepreneurial efforts—the participation in the earnings of the firm. If we are to effectively evaluate the efficiencies of our firms, I believe we should separate partners' compensation for services provided from their participation in the earnings of the business. The question then is how to set their salaries.

Setting partners' salaries for evaluative purposes does not necessarily mean setting draw, which is merely the amount of cash taken out of the business. Briefly put, the marketplace sets salaries. For example, if you hire an employee and propose to pay him $25,000 a year and bill him out at $50 an hour (which is acceptable in the marketplace at his level of experience), then the marketplace has set his rate and therefore the ratio. A partner who sets his own hourly billing rate at $150 is therefore saying that the marketplace is willing to pay him the equivalent of a $75,000 salary (three times that of the employee) for his marketable skills. If this is so, any compensation above and beyond the partner's technical worth in the marketplace is either a function of his entrepeneurial abilities or return on capital.

In our firm, we take the classical or historical costs of operations plus an allowance for partners' salaries, as well as interest on the opening accrual basis capital accounts at the prevailing prime rate. We believe it is only by subtracting these economic costs from revenues earned that one can arrive at the actual net profit.

If we take all the time charges at standard (we all tend to use standard hourly rates) and determine a ratio to all the costs as previously defined, the result should be the standard cost percentage for every standard dollar of time. It is then relatively easy to evaluate the efficiency of operations based upon that ratio and make comparisons from one year to another and between entities.

Also, if we accept the premise that it costs X number of dollars to generate Y amount of revenue, any deviation from the revenue at standard can be viewed as either an overhead or bottom-line cost, much as in any cost accounting system of a manufacturing operation. In our firm, we evaluate deviations from standard as bottom-line costs because we are oriented to providing one single product—billable hours. We use a cost and profit center base for setting our relative compensation in the ensuing year. The exhibit on page 5 is a brief summarization of how we determine our profitability and relative compensation per partner.

Now, after going through this analytical process, certain things become apparent, one of which is that our primary unit of production is billable hours. Our hourly rates are limited by the marketplace and the number of billable hours each individual can generate is limited by the number of hours he can work in a year. If our firm is to grow, we are compelled to increase the number of billable hours each partner is responsible for generating—i.e., not his

Method of setting up a standard cost system

Standard hourly billing rates exist for all members of Weiner & Company, partners and employees alike, and all direct client-related time is charged on this basis. It is generally the policy of the firm to realize these rates on services provided, underage or overage becoming an additional cost or profit to the firm. Hourly billing rates have been set by the firm for its professional and support personnel as ratios of their annual salaries plus an allowance for other than out-of-town expenses. In 1982 the constant applied against an employee's compensation was .002.

Exception to the above rate formula is taken for the determination of a partner's salary which is to be the economic cost of a partner to the firm based upon his market value. Market value is self-determined at a standard hourly rate. Salary is arrived at by dividing standard hourly rate by a constant (.002 in 1982), as follows:

$$\frac{\text{Standard hourly rate}}{\text{constant}} = \text{Partner's salary}$$

Allocation—The allocation of profits to the partners of the firm is the end product of a series of calculations and objective criteria. A logical sequence has been detailed below.

Profit as standard equals total standard hourly rates for the year less all operating expenses including partners' salaries and interest on capital.

The *net profit* is the profit at standard adjusted for any deviations from standard, i.e., write-ups or write-downs.

Earnings shares are calculated as follows:

Step 1: Profit at standard is expressed as a percentage.
Step 2: The standard time charges per administrator are totaled.
Step 3: Step 1 is applied to step 2 to arrive at the profit at standard per administrator.
Step 4: Profit at standard per administrator plus or minus any deviations from standard results in the *net profit contribution per administrator,* which is subject to two further adjustments before determining each partner's quantifiable contribution to the profits of the firm:

(1) One-half of the net profit contribution per administrator is credited to the firm. This recognizes the firm's contribution to the attraction and retention of clients.
(2) One-half of the remaining ($\frac{1}{2} \times \frac{1}{2} = \frac{1}{4}$) profit (loss) on a specific account basis is credited to the originator of the client if different from the administrator. This recognizes the fair value of the client originator.

Step 5: The sum of each partner's salary plus the net profit attributable to him relative to the respective sums of every other partner is then expressed as a percentage, the numerator being the sum of a partner's salary and quantifiable contribution and the denominator being the sum of all partners' salaries and quantifiable contributions, equaling *percentage earnings shares.*

The percentile relationships as determined above, which were based on the economic performance of the year just concluded, are the percentage earnings shares by which the succeeding year's net profits are allocated after compensating the managing partner and after additional subjective evaluation, to the extent required.

personal billable hours but rather the billable hours of the people working on client engagements for which he is responsible. In order to increase these billable hours, the limitation becomes how well he can leverage his skills through others.

Surveys show that medium-size firms seem to peak at a ratio of approximately six staff people (assume two are clerical) per partner, whereas the national and international firms have ratios ranging from 12 to 18 people per partner. Let's assume that the average billing rate of a firm's people is $50 an hour and that a professional staff person averages 1,700 billable hours per year. In a firm with a professional staff-to partner ratio of four to one, the gross potential billings per partner are $340,000 (6,800 hours at $50 per hour). If we accept the old premise of one-third for overhead, one-third for direct labor and one-third for profitability, we find that the average partner can have an earnings level on staff of approximately one-third of that, or $113,000, plus the profitability associated with his own time. Surveys show that once firms grow to a certain size, most partners tend to generate fewer billable hours—around 1,000 or 1,100 hours each. If we go back to our one-third divisions, we can see that at a standard of 1,700 billable hours, they are barely covering their base salaries and overhead.

However, if we are only able to realize 90 percent of standard, that would reduce the earnings by 10 percent of the gross (in this case $340,000 less $34,000), thus reducing the profit from $113,000 to $79,000. That figure, plus a salary sum of $50,000 is more in line with the average earnings of partners of very profitable medium-size firms.

Now, if we can approach a ratio of seven to one under exactly the same conditions including a reduction of 10 percent for nonrealization, we can increase the average earnings per partner from $130,000 to $190,000. This can be an appealing way in which to structure a firm for profitability.

Profitability is an essential tool of growth. Without adequate profits, a firm is unduly restrained in its ability to attract, retain and take the risk of investing in people who can help it grow.

–by Ronald G. Weiner, CPA
New York, New York

THE ORGANIZATIONAL PROBLEMS OF RAPID GROWTH (PART II)

December 1983

In order to achieve the higher leveraging of staff to partners, as discussed in the first part of this article, (see November issue), controls must be established. In our firm, the establishment of highly centralized controls enables our staff to have a high level of autonomy. For these controls to operate in the way we intended, we had first to consider the need for standards.

In 1976, when there were 12 people in the firm, we attempted to determine what the partners ought to be doing and how much of our time we actually expended on these functions. We identified the optimal responsibilities of partners as billing and collection, client advice and planning, client development, firm administration and technical excellence. However, we found we were spending only 20 to 30 percent of our time in these areas and the remainder on less essential functions, particularly on the maintenance and review of work papers and financial statements. It was then that we decided we needed someone to perform centralized review of all financial statements and work papers so that we could develop common performance standards. We employed a local college professor to come to our offices two days a week to perform this function.

Quality controls

The creation of the centralized review function was probably the most critical factor in terms of the ability of our organization to grow from within. It permitted standardization of work papers and the reporting process—both previously done on a partner-by-partner basis, and it enhanced our ability to delegate. We could now give our staff accountants sets of work papers which they could follow and people could readily be moved from one engagement to another. In order to achieve this level of standardization, it became necessary to teach people to do things in the manner we wanted. We found this difficult with people who had accepted another firm's methods as being the only way, and so we decided, whenever possible, to hire only people who had no prior work experience.

In our firm, the purpose of standardization is not merely to obtain consistent work paper quality but to add to our ability to delegate—delegation being the key to profitability. But in order to delegate effectively, one must have control, and for that we look to our centralized review department.

In the beginning, we saw centralized review only as a work paper and financial statement review function. However, in time it became apparent that the centralized review department was the only area that saw the work product of all the professional staff in the firm. Therefore, it seemed logical that this department should assume responsibility for developing training programs to help remedy people's weaknesses. Later, the department became responsible for the qualitative reviews of professional staff—i.e., for reviewing people's technical performances in preparing work papers and financial statements. Subsequently, because deficiencies in training, work paper presentation and workload distribution were most easily discerned by the review department, we included scheduling on its list of responsibilities. Suddenly, we found ourselves, not with a review department, but with a quality control department. In essence, we found ourselves moving, in an operational sense, toward the positions in SAS no. 4, *Quality Control Considerations for a Firm Of Independent Auditors,* released in June 1974. This is the first document to set forth factors to be considered by CPA firms, rather than individual auditors, to assure conformance with generally accepted auditing standards and to consider quality control in a much broader sense than merely review. It identifies nine elements of quality control. These elements have been incorporated into our quality control document.

Optimizing the use of productive resources

In our firm, control of the scheduling function is viewed as control of our productive resources—billable time. Each individual works so many hours per year and it is our objective, as manufacturers if you will, to assure that each person produces a consistent stream of quality products. Our director of quality control, who inherited scheduling from the partners, was able to handle the job until we grew to 50 people. As we continued to grow, the task became too complex.

If we look at every hour as a unit of production, then in a firm of 50 people, each working a 40-hour week, the number of units of production to be managed is 104,000 (40 x 52 x 50). The management of these units of production is not straightforward. It involves overlapping different skills at various levels with professional judgment, to ultimately manufacture a product. In addition, we faced the classic problem of every rapidly growing professional practice—a shortage of highly qualified personnel. These problems, coupled with the difficulty of scheduling our work in an orderly fashion so that it could move through our offices quickly and efficiently became too complex for a person of limited technical training. An objective review of our productive process prompted us, once again, to centralize the function and hire a specialist.

We provide accounting and audit services to clients that require the utilization of different skill levels not necessarily in matching time periods. Although standardization of work papers had been achieved, much of the work could be done by lower-level staff, while work paper review, certain aspects of the writing of financial statements and technical issues required the attention of highly skilled individuals. However, we assigned people, experienced and inexperienced alike, to complete the identified tasks together.

For example, on a typical engagement of two man-weeks of time, a senior and a junior were sent to the client's office regardless of the fact that perhaps 80 percent of the work to be performed was junior level and only 20 percent required senior-level expertise. As might be expected, the junior plodded along at his pace and the senior, who had completed his work or who couldn't proceed further at the time, helped the junior out on his tasks. Whatever the reason, it was obvious that we were not getting the leveraging and timeliness from our personnel that we had hoped for.

Let's take the work-flow one step further. A team goes out to perform an audit requiring people of varying skills to perform different functions. The staff completes the field work and brings the rough financial statement back to the office where it is submitted to the review department. After looking at it, the review department sends the financial statement back for changes and resolution of comments. After that, it goes through the review department again and then on to the typing department for finalization, preparation, processing, partner approval and ultimate delivery to the client. At the same time, the staff also prepares the tax return and submits it to the tax department where other people become involved. In effect, what is occurring is a network resource allocation problem somewhat analogous to the objectives of CPM and PERT.

Planning and scheduling

CPM (Critical Path Method) and PERT (Program Evaluation and Review Technique) are project planning and scheduling tools used primarily on projects whereby the interrelationship and dependency of different activities are critical. Often used on construction projects, maintenance projects, and designing or developing new products, these network planning techniques insure that overlapping functions are performed on a timely basis. For example, plumbers don't have to wait until the structure is completed before they commence their work and electricians don't wait until all other tasks are done before beginning theirs. After reflecting on these concepts along with articles we had read on short-interval scheduling in professional firms, it became evident that the logical choice was to turn to the profession of time management—namely that of industrial engineering. We then hired an industrial engineer to head our scheduling and planning function.

Her charge was to devise a new method of controlling our productive resources, the objective being to optimize the utilization of our personnel through leveraging and proper planning. To do this, we defined the functions performed by our personnel, broke these functions down into simple tasks, and estimated the time as well as the level of expertise required to adequately perform each task. This data was used to develop detailed budgets which then became integrated into our on-line time management system. The data base provides the foundation for scheduling, budgeting, forecasting optimal manpower requirements, and for evaluating the efficiency and utilization of our resources.

We have now had the system in place for three years. Initially, we met considerable resistance during implementation phases of the program, but the staff now finds it to be a handy, workable tool. In one year we found that productivity increased 18 percent—i.e., billable hours per professional. In addition, and perhaps most importantly, we estimate that we have been able to reduce the time spent providing a recurring service to a client by about 20 percent. This has enabled us to improve our rate structure and our realization to standard as well.

A survey published by the AICPA indicated that as of February 1981, there were 84 firms in the country out of 22,000 practice units that had 30 or more Institute members. I take this to mean that with the exception of a few firms, most practices have not yet found the means by which to grow to become self-perpetuating businesses. I believe that those of us who are dedicated to growth have a tremendous opportunity to perpetuate our firms if we can find the tools to manage our future growth. However, in order to have these tools, we must be willing to pay for them.

The ability to pay for these tools involves risk taking and requires that the firm be profitable. To achieve the requisite level of profitability necessitates leveraging staff, having efficient operations and reinvesting profits into the business so that the firm can grow. Profitability is not earnings per partner; it is the earnings of the enterprise after fair and reasonable compensation for its employees and partners. Profitability will only result if we make a recurring dedication to our firms' growth, and continued growth, in turn, can only be assured by providing quality services such as formed the basis for past growth. To achieve this degree of quality will require change, greater delegation and control.

–by Ronald G. Weiner, CPA
New York, New York

GROWTH IN THE EIGHTIES

April 1981

In order to survive today, CPA firms must find ways to cope with the pressures brought on by governmental regulations; litigation; and public, employee and personal demands. One way to do this is by taking advantage of the many opportunities to expand your firm that these pressures have created.

For example, governmental regulation itself often creates tremendous growth areas, and other factors such as professional rules and regulations and technology-caused changes all provide new service opportunities. However, translating opportunities into actual firm growth depends upon your ability to develop a suitable strategy based on your view of those opportunities and your desire and commitment to take advantage of them. You must also be certain that your firm can satisfy the particular service requirements and is willing to invest the necessary time and money.

A firm that is determined to grow must put together the right combination of the following six elements.

Financial results

It is best to measure results in terms which do not lose significance because of inflation (e.g., in chargeable hours) and to check often to determine that the growth is muscle, not fat. A growth rate of 10 to 15 percent per year is controllable even though it may require a 20 percent increase in staff. Any faster rate of growth may cause excessive costs in recruiting and training and could jeopardize quality.

You should set realistic operating profit goals, taking into consideration that the desired level of growth will cost some current profit. Your fee-setting strategy should reflect the fact that your organization offers unique services and that your clients are willing to pay for them.

Profit consistency is difficult to maintain in service firms but you should aim for it. Without a sound profit consistency plan, widespread diversification (which may ultimately lead to the desired profit consistency) may cause an unacceptable decrease in profits. Allow for some inconsistency, though, and be flexible so you can take advantage of new opportunities without disturbing your overall growth plan.

Basic concepts of business

These include the variety and quality of services offered, the geographic locality of the business and the commitment of your partners and staff to achieve a common goal.

To determine the variety of services your firm should offer and the degree of specialization needed, you must know your market (i.e., your clients' needs). Your firm's growth strategy should also include geographic considerations—whether you desire to operate as a local, regional or national firm—and you must decide what organizational structure is required.

Most CPA firms genuinely try to achieve high standards of quality. High quality seems to be part of an equation—it generates the profits that finance the growth that attracts the talented people and permits professional motivation.

Functional activities

There is a growing awareness of the need to apply the sound managerial concepts used in business to public accounting practices. In order to properly plan and support growth, you must establish your firm's internal structure.

For example, do you need tax, MAS, audit or industry specialization to support your planned growth? How do these various elements relate to each other and under what conditions should they operate? A great deal of attention must be paid to these details so as to eliminate duplication of effort and communicational breakdown. If decisions are to be made regarding expansion, specialization, personnel, etc., a firm needs to know where the profits originate and what the costs are. An adequate management information system is essential for properly planned growth.

New services development

Growth often comes from being able to offer unique services and from recognizing opportunities. Firms should constantly seek ways to improve their performances—see what more can be done for clients, etc., and be ready to capitalize on new situations. Carefully controlled new services development can lead to increased profits and motivated personnel. However, uncontrolled new services development can lead to disaster.

Marketing plan

A good marketing strategy is to first divide the market into segments. The issue then becomes what service is to be provided to each segment, by what techniques and to what degree of emphasis and profitability. Your marketing strategy should be to direct your efforts to where they will do the most good. Be specific. Concentrate on those things your firm does well.

General management

Certain characteristics stand out in the general approach taken by leading CPA firms in their overall management. Usually, they are organized in such a way to permit both functional specialization, as in tax practice, and industry (market) specialization, as in banking and construction, etc., with appropriate profit and loss accounting applied to each specialty. The degree to which specialization occurs should be based on the specialty's present or future profitability.

Finally, the organization must be adaptable to change. Only those firms that plan for change seem able to survive.

–by William T. Young, CPA
Madison, Wisconsin

FINANCING FIRM GROWTH IN THE 1980s

February 1982

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

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

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

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

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

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

Small firms have a real advantage when it comes to people relationships. Being small makes it easier to train, develop and motivate personnel. Unfortunately smallness also breeds informality which can lead to personnel problems. There is a need to formalize personnel policies in a way that requires us to provide timely and effective performance and career counseling to staff. Perhaps you should think about giving earlier recognition to outstanding people—even to shortening the time to partnership. You might also consider offering financial assistance if yours is an area with exceptionally high housing costs.

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

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

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

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

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

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

Becoming Better Business People

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

The causes

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

Remedial procedures

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

Billing techniques

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

Engagement administration

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

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

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

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

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

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

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

–by Gerald L. Yonke, CPA
Seattle, Washington

MANAGING RAPID GROWTH

August 1988

From its founding as a sole proprietorship in 1969, our firm had become a forty-eight-person, seven-partner practice by the end of last year. Growth during the last five years has been particularly rapid. Revenues have tripled, and chargeable hours have almost doubled during the period. The challenge to me, as managing partner, has been in how I can effectively manage twice as many chargeable hours and maintain profitability.

Our firm is willing to spend time and money to find out how effective our management is, and to obtain help where necessary. Our first step in this direction was to participate in the AICPA local firm management consultation program (see page six of the November 1987 issue). Then, three years ago, we engaged two partners and the office manager of a successful local firm to review us – to visit our office, interview everyone in the firm, and report back to me. Last year, a perception survey conducted by a clinical psychologist was completed to determine the effectiveness of management in helping the firm attain its goals. We believe in growth, but we have to be careful not to fall into the trap of becoming less profitable as we grow.

Firm growth means different things to different people. You have to analyze your practice to determine areas of growth and what it is you are trying to manage. The real question is why we choose to grow.

I believe that if any firm is to be successful in the future, it has to grow in order to

- ☐ Provide opportunities for staff to advance economically and professionally.
- ☐ Recruit top graduates. We tell students how our firm is growing and how this can provide them with career opportunities.
- ☐ Attract larger and different clients, and be able to provide services to growing clients.

☐ Provide buy-out/retirement for partners.

A few years ago, we tried to determine why we had grown in the past and to plan our future growth. Some of the reasons for our growth were the reputation of the firm and the quality of our work. And some of it was due to good old-fashioned hard work, luck, timing, and connections. Aggressive leadership also played a part.

Our plans were fairly successful, but we grew faster than expected. Such fast growth is often accompanied by a number of problems. Let's look at a few that we experienced.

Attitude. Partner productivity was an issue we had to address. Partners wanted to spend more time developing business and on administration of the firm than working on engagements. We wanted to be sure all partners were committed to the firm and had the right attitude about it.

Morale. The close feeling typical of small firms can become lost as new staff are added and working groups formed. This is mainly a matter of perception, but one that partners and managers should address.

There have been a number of studies and articles exploring the reasons for and effects of worker dissatisfaction in the U.S. Too heavy a workload, insufficient time to do the job properly, poorly defined responsibilities, lack of support from colleagues and supervisors, and limited opportunities for advancement are some of the reasons for such dissatisfaction. The major effects on workers are job stress, anxiety, depression, poor self-image, and deteriorating health. The ultimate effect is staff turnover. Many times, we don't think about the morale of members of our firms. But again, this is an issue that should be addressed.

Increased organizational structure. We thought we would need an increased number of reports, schedules, and memoranda as the firm grew, but finally realized that this had become a problem. Much of the information generated wasn't being used, and the decision process was being slowed. We had also formed committees, but found we weren't responding to them, acting on their recommendations, or even giving feedback.

Communication. Partners did not seem to have the time to talk to staff and clients as was possible when the firm was smaller. People want to be kept informed, however, and staff must know about changes in policies and plans if the firm is to be successful.

Productivity and profitability. We were not obtaining the proper percentages in terms of chargeable time and billing realization, and collections had become a problem. People just weren't involved in the process. Getting collections up and work out on time, watching bad debts and expenses, explaining why fees had increased, and reassuring clients that they had not become too small for our growing firm were some of the other issues that we faced during this period of rapid growth.

Addressing the issues

If such problems are to be addressed, then the necessary leadership must come from the managing partner. It is the managing partner's responsibility to sell the staff (the team) on a vision—on the purpose of the firm and on what he or she is trying to achieve. The managing partner must be more involved in leadership than anyone else. Most of all, he or she must be the firm cheerleader and must set a positive example.

This requires an understanding of power and ego. As managing partner, you have to share the publicity and ego gratification. You have to learn what people want and give it to them. Give them autonomy—ownership of the task, for example. (In our firm, we hire bright people and allow them to grow and progress as fast as they can.) Equality of opportunity, meaningful work, a sense of belonging—these are the things on which we all need to focus.

We have to encourage people to experiment and give them the ability to use their talents; but we must also be willing to risk the occasional failure. The solution is to find people with good, complementary skills, who can work well together. And remember: Recognition does not just happen. It is an attitude that you should practice every day.

If staff is to have good feelings about the profession and be productive, it is essential that the managing partner project a positive image and set an example. It is the managing partner who holds the solution to the problems associated with rapid growth.

We found that it is too easy to become complacent about technical competence when you are very busy. Therefore, a minimum acceptable level of expertise in the firm was established, as well as a minimum level of work for partners, both in terms of total hours and chargeable hours.

While staff morale can be adversely affected by committee structure, we also discovered that committees can help by getting people involved. Now, though, we listen to the committees and react to their recommendations. We make an extra effort to address staff needs, too. The number of social functions within the firm has been increased, and a liaison group formed which meets together once a month, and with me once a quarter. One member of the group is appointed to work directly with me so that partners can get input from staff. In addition, I make sure I spend a little time with everybody everyday.

We reviewed our organizational structure and cut back to half the number of reports and memos being produced three to four years ago. We didn't need that quantity of information. We also began to look at flexible policies such as compensatory time, in the belief that as situations change, so should policies.

Telling people where they fit in is important. We hold firm meetings four times a year to talk about results—where the firm is going and the goals for next year—and to engage in some team-building exercises. The idea behind these exercises is that people do better working as part of a team than they do individually.

We tell staff what the firm's needs are, what its goals are, and what the overhead is. People are then asked how the firm can get its productivity up to the desired levels. Our staff has come up with some good ideas, and the feedback has been positive.

Regarding timeliness of work, the administrative staff was asked the reason for the bottlenecks. Staff now works continually on ways to improve the timeliness of our work product. No one is allowed to put ASAP on a report anymore, but must go to the typing department to ask for help.

The "We Care" program

This program was started about eighteen months ago. Everyone in the firm is asked to demonstrate concern for fellow employees, clients, and the profession. "We Care" about returning phone calls, client service, and firm profitability. We let clients know that we manage the firm so that it *will* be profitable. We have "We Care" signs in our reception area and in the cafeteria and wear "We Care" lapel pins. The slogan is on pencils that we use and give away, and each week I write a "We Care" column for our internal newsletter.

The result of this effort is that our firm is more profitable than ever before. Gross fees rose thirty-five percent last year, and chargeable hours were up twelve percent. I believe that growth is the future for an accounting firm, and that leadership, communication, team work, and rewarding excellence provide the answers to problems that can accompany rapid growth.

—by **Jerrell A. Atkinson, CPA,** *Atkinson & Company, Ltd., 707 Broadway N.E., P.O. Box 25246, Albuquerque, New Mexico 87125*

GROWTH AND DEVELOPMENT—ONE FIRM'S APPROACH

April 1989

When Mitch Aigen, Dick Eisner and Ted Levine began their firm in December 1963, they saw an opportunity for a firm that provided clients with high-quality professional service and personal attention. Since then, their understanding of their particular niche has paid off.

Revenues at Richard A. Eisner & Company, just $35,000 in the first year, are expected to exceed $30 million in 1989. Today, nearly 300 people make up this single-office New York City CPA firm.

As the firm grew, the partners realized they had to hire and develop talented people, and place them in positions where they could best fulfill their potential. While they continued to expand their college recruitment program, they concurrently had to hire experienced people to fill special needs. By paying competitive salaries at all levels, offering interesting and challenging work opportunities, and providing a caring work atmosphere, they have been able to attract the talented individuals they need and that clients appreciate. In addition, all members of the staff are encouraged to find areas where they can both find self-fulfillment and, at the same time, be most helpful to the firm. If this means transferring to another department, they have the opportunity to do so.

To provide high-quality services to clients, the firm has always emphasized the overriding importance of teamwork between individuals and between departments in the firm. Teamwork exists through the team service approach, in which a partner from each department is assigned to a client. The partners meet regularly to discuss the client's particular needs. This way, clients are treated as clients of the firm, rather than those of a particular partner.

The firm's approach to personnel development and client service has benefited everyone. Turnover among both firm professionals and clients, in fact, is among the lowest in the profession.

Expanding into new areas

In the beginning, the firm's growth was moderate and did not accelerate until the partners shifted their focus to SEC clients. Growth slowed by the early 1970s, however, when there was a cutback in SEC offerings. At that time, the partners realized that a narrowly focused firm could not attract talented individuals. In order to do that, they decided to expand into new areas and develop expertise in specific industries. As a result, the firm became involved in areas outside the traditional ones of accounting, auditing, and taxation. New departments offered expertise in management advisory services, personal financial planning, litigation support, insolvency, mergers and acquisitions, telecommunications, strategic marketing, and benefits consulting.

The firm also has recently become the coordinating firm of Summit International Associates, Inc., a global association of independent regional accounting firms located in most major financial centers throughout the world.

Fundamentals to firm culture

Richard A. Eisner & Company now offers a broad range of accounting, tax, and management consulting services to both public and private clients in many industries. The partners provide much the same range of services that national firms offer, but with the flexibility and personal attention of a local firm. The balance between the range of diversified expertise and service remains an important part of the firm's culture.

That culture also embodies a commitment to continue to increase expertise, add vital new services, and encourage individual development and innovation. At the same time, there is a commitment to the fundamental principle of close proactive attention to clients' needs. ☑

Section 12

A FEW MORE IDEAS

TURNING TELEPHONE CALLS INTO CASH

March 1990

It has always been standard practice in our firm not to charge for short telephone calls, and we let our clients know that. This encourages them to call when they have a problem. The problem then does not get "buried" in the books only to be discovered later through the tedious process of reconciling account balances. The same goes for tax questions.

There are also client relation benefits to this practice. Our clients feel we are accessible to them, that their questions are important, and, thus, that *they* are important to us.

There seems to be only one drawback to this policy. No matter how long we talk together, the client always considers it to be a "short" phone call. Occasionally, I have received a negative response when I have attempted to bill a half-hour phone conversation.

To overcome this difficulty, we developed a follow-up memorandum which we fill out on each phone conversation we plan to bill (see page 5). It records the questions asked and the solutions we have suggested, and includes sections for specific instructions to the client and the member of our staff. The memorandum is printed on two-part NCR paper which allows us to mail one copy to the client and to file the other. Since we began this process of notifying clients of the service provided, we have had no complaints about billing for telephone calls.

Other practical uses

During the recent tax planning season, we made use of the forms for in-office consultations as well. In the memo section, we briefly detailed the current tax status. In the to-do sections, we discussed tax planning moves to be made before year-end. Then we attached a copy of our tax planning software summary printout.

This is the first year we have done this, and the results have been excellent. The clients had a clearer picture of the actual tax savings involved and of what tax liability would be owed. They also knew what they needed to do before December 31.

From the firm's standpoint, we know exactly what we recommended and the results we expected to attain. Several clients have called back about altered circumstances after the initial planning session. Revising the plan was a snap.

If you are not billing for those "short" phone calls but wish you could, or if you are not comfortable with your current documentation practices for informal client meetings, you might try this simple solution. It works for us. ☑

—by **J. Terry Dodds, CPA,** *397 Blue Lakes Boulevard North, Twin Falls, Idaho 83301*

FOLLOW-UP MEMO

Client ______________________________ Date ____________

In our office ____________ Client's office ____________ Telephone ____________

Consultation between ______________________ and ____________

Regarding ____

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Memo:

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To Do - You:

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To Do - Us:

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COLOR-CODED READING

October 1984

As a small local firm—two partners and five professional and paraprofessional staff members—we are constantly trying new ideas and techniques to help improve our efficiency. About three years ago, we initiated a policy that we hoped would avoid duplication in tax and other research.

It is a simple policy. Each professional and paraprofessional is assigned a different color and encouraged to use a marker of the same color when highlighting tax and technical materials. As a result, when another person is researching a problem, he or she is alerted by the highlighted areas that the material has been reviewed and can identify by the color the individual who has studied it. The two can then meet to discuss the problem.

We find that by highlighting technical material, books, magazines and other publications this way, we can avoid duplicate research and encourage discussion among members of the staff. In addition, this simple technique has helped us meet our goal of doing a better job for our clients and has increased our profitability. ☑

–by Lawrence R. Kopsa, CPA
York, Nebraska

LETTERS TO EDITOR

October 1983

Individual tax-return workpaper filing system

I enjoy the hints in the *Practicing CPA*, and Mr. Daniel's article on color-coded workpaper files, in the August issue, inspired me to share my individual tax return workpaper filing system. Over the years, I have noticed that even firms which are very proud of their workpaper standards tend, nonetheless, to have terrible tax files—especially for individuals. After years of experimenting, I have finally settled on a standard workpaper technique which I think other practitioners might find useful.

Every one of my individual tax files is organized the same way so I can always find what I want quickly. The files include: federal return, state return, tax docket, letter of transmittal and instruction sheets, diagnostic review from computer service bureau, service bureau input, workpapers, systemizer, and research, extensions and estimates (all with tabbed dividers).

The workpaper referencing system is probably the most important aspect of the program. The workpapers are referenced to correspond to the form numbers of the tax preparation computer service bureau. For example, three pages of workpapers pertaining to the service bureau's form 5 would be referenced 5-1, 5-2, 5-3. The service bureau's forms become, therefore, an automatic lead sheet for the workpapers. Where data going to different service bureau forms is carried from a single workpaper, I reference the workpaper to the principal "lead sheet" and make cross-references in the margin of the workpaper and on the service bureau form.

The beauty of this system is that, while it is comprehensive enough for the most complex returns, it doesn't add red tape to the organization of very simple tax files. This uniformity makes it easy for staff and partners to review files or capture specific data without leafing through the entire file. Post-return activity (amended returns, RARs, etc.) is bound on top of the original return, with a tabbed divider, so the original return can be accessed quickly. I tend to use a new file every year, so estimates are filed in the following year's return.

–Robert A. Ortalda, Jr., CPA
San Francisco, California

Filing System for Client Information

Before opening my own practice, I worked for a large firm that engaged in numerous mergers and also for a local firm. As a result of this experience, I have been exposed to several different filing systems that suit the needs of various CPA firms. I attach a description of my present filing system, both in response to your request for additional practice management ideas and, also, because I believe it best suits the needs of a small practice.

The basic division of the filing system is workpaper, tax, special and permanent files. The first three are manila folders with an end cut and bound inside so that they read like a book. The permanent file is a classification folder style with four sections.

All folders are fully described on the end tab by the use of color-coded stickers. At the bottom of the folders are three color-coded letters which correspond to the first three letters of the client's name. Then there is a long tab containing the client's full name and, if necessary, an additional description of the contents of the file. Next, there is a color-coded tab marked W., T. or S., depending on whether it is a workpaper, tax or special file, and lastly, a color-coded tab indicating the year to which the file relates.

Each file folder contains no more than one year's information. If a single file becomes too bulky to contain all the information for a given year, the information is then subdivided logically. For example, all the income tax returns for a particular year would be in one file and another file might contain all the payroll tax returns.

Special files are created for any singular project that generally is not repetitive. Special files are often used for such things as a purchase or sale of a business, MAS projects or extensive Internal Revenue Service audits. Also, if a particular section of the permanent file becomes too bulky, a special file is created.

The permanent files are divided into four sections. The first one is for historical information which would include incorporation papers, minutes, the client data information sheet, subchapter S elections, etc. The second section includes copies of any agreements, contracts, loans and other legal documents. The third contains accounting system documentation, such as chart of accounts, forms and internal control documentation. Carry forward workpapers such as depreciation schedules, loan amortization schedules, stock basis for subchapter S corporations and similar items are filed in the fourth section.

The significant advantages of this filing system are the easy purging of old files to inactive storage, and the ease with which misfiled folders are located. Also, only the files one wants need be pulled, not all files relating to a client, and only one type of folder need be purchased for all types of files, thus reducing cost. In addition, the basic system is flexible and can grow as clients grow.

—Christine A. Lauber, CPA
South Bend, Indiana

FAST COLORS

August 1983

Have you ever thought about all the time everyone spends going through the client files to select the right folder? Benjamin S. Daniel, a Chicago practitioner, says that over the years his firm developed a system which greatly hastens selection. It uses different colored folders for designated purposes and files the folders in the same sequence for each client as follows:

File folder sequence (front to back)	*File folder color code*
Correspondence	Pink
Special	Brown
Payroll taxes	Purple
Permanent	Green
Insurance	Orange
Fixed assets	Yellow
Current-year working papers	Blue
Individual income taxes (Separate file drawer)	
Federal	Blue
State	Red
Corporation, partnership and trusts	
Federal	Orange
State	Yellow
Other	Purple

Mr. Daniel says that everyone becomes aware of the color code after a while and automatically selects the right folder. If other readers have ideas or procedures that facilitate running an accounting practice, please send them along to us.

AN EXTRA TICKLER FILE

April 1980

We have always provided special envelopes for our clients to use when mailing income-tax returns to the various agencies. In the past, when a client failed to put sufficient postage on an envelope, it was returned to our office because ours was the return address on it. Not only did we have to re-mail the return, but the delay increased the risk of a penalty being imposed. So, wanting to shift the responsibility for a delay to the one causing it, we decided to change the return address.

We do this with labels generated by our computer from our client list. The labels are produced (three in a row) in alphabetical order (by client), grouped by type of return (corporation 1120, partnership 1065, fiduciary 1041 and individual 1040) and placed in a notebook at the beginning of the year.

When a client's returns have been signed by the partner-in-charge, the labels are removed from the notebook. One is used to address the envelope in which we send the returns to the client; the other two are put on the envelopes (as a return address) we provide the client for mailing federal and state returns to the governmental agencies.

As a result of this procedure, the notebook of unused labels is an extra tickler file, reminding us that while each person in the preparation process may claim, "I got my part done," the returns have not been delivered or mailed to the client.

When the normal filing deadline is reached, the labels are marked "extension" by the person mailing out the application for extension of time. This way, we know at a glance that the extension has definitely been filed.

When the returns require more than two envelopes (multi-state tax returns), the partner-in-charge and the staff know that additional labels are required and can request them. And, should a client discontinue our services during the year but before the return is filed, the labels are removed from the file by the partner who writes up the terminated client memorandum.

The end result of this process is that we always know which returns have been delivered. We have also made addressing envelopes and providing correct return addresses simple.

–by Stephen D. Tanner, CPA
Morgantown, West Virginia

CASH MANAGEMENT

July 1980

Every business person wants to improve cash flow in these days of high interest rates and a slowing economy. Here are a few suggestions from the client newsletters of Paul Browner and Gallant, Farrow & Greene.

- ☐ Take advantage of discounts when paying bills. If you pay a 2/10 net 30 bill by the 30th instead of the 10th, it costs you 36 percent annual interest. If you pay it the next month, it costs you about 15 percent annual interest.
- ☐ Get to know a couple of banks. The time to talk to bankers is when you don't need money. Keep them informed about your business.
- ☐ Deposit funds in a savings institution or money-market fund that pays daily interest. Earn your interest and transfer funds to a checking account when needed.
- ☐ Never date a statement with the first day of the month—use the last day of the previous month. It's a month older and there's a good chance it may be paid sooner.
- ☐ Give priority to the processing of large dollar volume invoices.
- ☐ Initiate progress billings where the work being performed is stretched over a period of time.
- ☐ Make bank deposits daily and time your deposits so they are included in that day's receipts by your bank.
- ☐ Accelerate the collection process by shortening the period between follow-ups of delinquent accounts and by generally pursuing more vigorous collection procedures.
- ☐ Age accounts receivable monthly to help in identifying delinquent and slow paying accounts.
- ☐ Review your billing and collection systems and procedures to determine if mechanization or computerization would speed the collection process.

Accounts receivable, unlike fine wine, do not improve with age. Inflation, chance of loss and interest charges all work against that. Maximizing cash inflows and earning the most you can on surplus funds make good business sense.

THE ALTERNATIVES TO LITIGATION

June 1987

With the number of cases against CPAs continuing to grow, litigation has become increasingly burdensome for them. An aggressive defense requires expensive legal services; the time and attention of professional staff are diverted from productive activity; business relationships may be disrupted; and the firm may suffer embarrassing publicity. Perhaps the greatest burden, though, is the uncertainty that a fair result will be achieved because of the inability of judges and juries to grasp accounting and auditing concepts.

There are other approaches to the typical confrontational posture inherent in traditional litigation, however. The Alternative Dispute Resolution (ADR) movement, for example, emphasizes reaching mutually advantageous solutions through the use of several cooperative techniques.

Arbitration is the most formal alternative dispute resolution technique and the only one that produces a binding resolution. Arbitration is authorized by statute. Lawsuits filed in contravention of an arbitration clause can be enjoined, and an award by an arbitrator is enforceable in court with limited judicial review.

Generally, no discovery is available. Thus, witnesses cannot be forced to provide testimony and documents in advance of "trial," and legal challenges to the procedure are limited. This greatly reduces the expense of litigation but sacrifices full development of the facts.

Court-annexed arbitration is nonbinding arbitration required by the court. The procedure is being adopted in many state and federal courts, and as it is done in connection with a pending case, discovery is allowed. In some states, if the recommendation by the arbitrator is rejected, a party may be liable for its opponents' attorneys' fees if the ultimate resolution is adverse to that party. Studies have shown, however, that between 50 and 75 percent of the litigants accept the recommendation of the arbitrator.

Mediation is a process in which the parties to a dispute select a third party to help resolve it. The mediator does not make a decision but attempts to narrow the issues, and encourages both sides to reach their own resolution.

Minitrials have reportedly been successful in quickly settling complicated disputes between sophisticated parties. At a minitrial, senior executives of the parties hear abbreviated presentations of each side's best case by both sides' attorneys, in the presence of a neutral observer. The executives then meet to try to reach a resolution. The success of minitrials is attributed to their providing a neutral and analytical assessment that forces litigants to confront the weaknesses in their cases.

Application of ADR to CPAs

Unlike litigation, ADR techniques are not compulsory. Thus, accountants who are sued in normal litigation have to defend against the lawsuit and cannot avail themselves of ADR techniques absent some special arrangement, such as a specific agreement. Consequently, ADR techniques will usually be restricted to disputes with clients, as opposed to third parties.

One approach would be for an accountant and a client to agree at the beginning of the relationship that any disputes between them will be determined by ADR procedures. Such an agreement could be included as one element of an engagement letter. Alternatively, it could be the subject of a separate arrangement with the client. "Dispute clauses" and arbitration provisions are frequently included in professional service contracts. The exhibit below contains two model ADR paragraphs for an engage-

Exhibit

Model arbitration paragraph

Any controversy or claim arising out of or relating to our engagement to (describe service, e.g., audit the company's financial statements) shall be resolved by arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association, and judgment on the award rendered by the arbitrator(s) may be entered in any court having proper jurisdiction.

Model general ADR paragraph

In the event of any dispute between us relating to our engagement to (describe engagement, e.g., audit the company's financial statements; prepare the company's tax returns), we mutually agree to try in good faith to resolve the dispute through negotiation or alternative dispute resolution techniques before pursuing full-scale litigation.

ment letter—one specifically for arbitration and the other for more general procedures.

Of course, implying that there could be serious disputes might not be the best way to start a client relationship. If this is a concern, it may be possible to suggest the use of ADR procedures after a dispute has arisen. In these circumstances, it is also likely that mediation or a minitrial would be the most useful procedure.

Although less easy to invoke when clients are not involved, and difficult to arrange in advance, the possibility of applying ADR procedures to disputes between CPAs and third parties should not be ignored. In many respects the incentives for third parties will be the same ones that in similar circumstances motivate CPAs and their clients—namely, prompt, less costly, and frequently better informed adjudication.

ADR resources

There are several organizations offering ADR services, training, seminars, and educational programs. These include the Center for Public Resources, the American Arbitration Association, and the American Bar Association special committee on dispute resolution.

Over 200 corporations have signed a pledge proposed by the Center for Public Resources that commits the signatories to explore the possibility of resolving disputes with other signatories through negotiation or ADR techniques before pursuing litigation. Subscribers retain their right to proceed with litigation if ADR fails.

ADR techniques will not be appropriate in every circumstance. In those instances, however, where the opponent is reputable, the issues complex, and the stakes high, flexible ADR approaches may provide a way for CPA firms to reach a fair result at less cost, and with less wasted time and embarrassment than they would through traditional litigation. ☑

Editor's note: The above article is based on a paper prepared by the special committee on accountants' legal liability.

SOME WAYS TO CONTROL MALPRACTICE COSTS

April 1988

The article, "Alternatives to Litigation," in the June 1987 issue, which explored several Alternative Dispute Resolution (ADR) techniques, contained two model paragraphs for an engagement letter. One was designed specifically for arbitration and the other for more general procedures. A partner of one local firm asked how such a paragraph would affect the firm's professional liability coverage in the AICPA plan. Other practitioners might also find the following response helpful:

There is a question on the application for coverage in the AICPA plan which asks whether the applicant's firm uses engagement letters for audits, reviews, compilations, tax returns, pro-forma statements, tax advice, tax shelters or MAS work. A negative answer could conceivably incur a premium surcharge by the insurance underwriters for the plan.

The AICPA liability insurance plan committee has strongly endorsed the use of engagement letters by all insureds in the plan as a means of reducing claims. It has not specified the type or content of the engagement letter which should be used by insureds, however.

The addition of an arbitration paragraph is a further means of reducing the possibility of a claim being filed against an insured, although it will not reduce the premium for the coverage sought. It might indirectly affect the premium in future years, though, because prior claims can incur a surcharge by the underwriters when they review the insured's annual renewal application.

Lawsuits and professional liability insurance are, of course, on every practitioner's mind. In speeches at several state society meetings last year, Norman C. Batchelder, executive director of the New Hampshire Society of CPAs and chairman of the AICPA professional liability insurance plan committee, suggested a number of steps firms could take to protect against liability claims.

The first one would be to control the quality of the firm's clientele through formal policies establishing the type of clients you want to serve, and through regular, written client evaluations. Mr. Batchelder suggests being alert to clients with financial or organizational problems, and to unusual turnover in key financial personnel and outside advisors. He also says to heed the danger signal if a client refuses to sign an engagement letter or provide a signed representation letter.

Mr. Batchelder advises obtaining a signed engagement letter for every engagement and obtaining complete representation letters when appropriate. He says, "Don't be casual about these matters."

Mr. Batchelder also advises producing clear, complete workpapers that document compliance with all pertinent professional standards and which conform to the firm's quality control policies, documenting consultations and conversations, and completely reviewing all work.

One last note. Do not sue for fees unless you hold a promissory note, and even then, reconsider. Mr. Batchelder says that approximately 10 percent of the claims in the AICPA plan are countersuits to the insured accountants' fee collection suits. ☑

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