Public Practice E-News
December 2015

This electronic newsletter is prepared especially for public practitioners and is sent bi-monthly to members of the Puerto Rico Society of CPAs. This e-newsletter features regular commentary from TSCPA Member Bill Reeb, a CPA firm consultant based in Austin. For questions or comments concerning the articles featured in this issue, or to suggest future topics, please e-mail Reeb at bill@tscpa.net.

From the BILLiverse
In this issue, Bill Reeb begins a new series on the long-term impact of building an upside down pyramid and how to correct it. While the upside down pyramid can be a very profitable approach to workload/capacity utilization for small firms, it will become a significant barrier to success as a firm grows. As the firm continues to expand and load more work into the upside down pyramid, it will likely then morph to a more dysfunctional hour glass shape. As firms progress through capacity models, at the point when the partners and managers start to burn out or the senior partners start seeing a near-term horizon to retire, they commonly either see the error of their ways and begin the required painful shift to establishing a right-side-up pyramid or recognize that the journey is too uncomfortable to make and decide to merge with another firm. How and why does this happen?
Read Reeb's commentary
Link to Bill Reeb article

Chaos in Tax and Accounting Pricing
Rick Telberg's article discusses the new *CPA Trendlines Price Strategies and Trends Survey*. The survey found inconsistent strategies in the profession, including over a third of respondents saying they lack a consistent strategy for setting rates. To put it another way, respondents said they have a consistent strategy of adjusting rates as necessary to accommodate the needs of both the CPA firm and any given individual client.
Link to Rick Telberg article

CPA Firms Place New Services at the Top of Their Innovation Priority List
CPA firms consider new client services to be their top innovation priority for the next 12 to 18 months, but firms that have embraced cloud technologies see more urgency in making those additions. This was a key finding of the CPA.com *Innovation in Public Accounting Survey*. Asked to name their top innovation priorities, firms placed highest importance on the development of new service offerings for clients.
Learn more
http://www.journalofaccountancy.com/news/2015/dec/new-cpa-firm-services-201513498.html

Four Ways to Raise Rates Without Driving Clients Away
Clients get into the routine of paying a certain amount for your services and you may be reluctant to raise your rates if pricing competition is fierce. Clients don't want to pay more if they can avoid it, but they will spend a little more if they understand and agree with your rationale. This article discusses four strategies CPAs can use to raise rates.
Read the article
http://www.accountingweb.com/practice/clients/4-ways-to-raise-rates-without-driving-clients-

away

What Clients Want From CPAs
It is important for CPAs to know both what clients want and what tends to drive them away. Understanding the client's mindset will allow you to provide better service, which leads to higher retention rates and to more of those lucrative referrals. So how do you know what clients want? Small business owners offer tips to assist you in improving your practice.
Learn more
http://www.journalofaccountancy.com/newsletters/2015/nov/what-clients-want-from-cpas.html

Using Customer Stories to Win New Business
From case studies and user-generated content campaigns to testimonials and online reviews, customer stories can be incredibly powerful tools to catch the eye of specific customer segments, persuade new buyers and quickly close sales. They can also establish immediate trustworthiness and reputation. In this article, three small-business leaders reveal how incorporating customer stories into their marketing helped them increase sales and win over new customers.
Read the article
https://www.americanexpress.com/us/small-business/openforum/articles/using-customer-stories-win-new-ones/?extlink=Enterprise2015_GrowthPartner_Q4_PaidMedia_Smartbrief

The Dangers of Dabbling
CPAs often look to diversify their service offerings to meet evolving marketplace needs. However, undertaking a new offering or providing service to a client in an industry with which the CPA is unfamiliar, frequently referred to as "dabbling," can elevate the risk of errors and professional liability claims. The reasons for this include inexperience and inadequate training, which may limit the CPA's ability to identify and address issues.
Get the details
http://www.journalofaccountancy.com/issues/2015/nov/cpa-firm-dangers-of-dabbling.html

How to Admit New Partners: A Fresh Approach
The long-term viability of accounting firms depends on providing a path to partnership that is affordable for new partners and not too costly for current owners. This often leaves firms with little choice but to seek a succession solution that includes a firm sale or merger. Fortunately for firms seeking long-term independence, several approaches can facilitate a successful ownership transition. This article illustrates a method called average annual valuation, or AAV. It can bridge the gap between those seeking admittance into a partnership and those already holding ownership stakes.
Read the article
http://www.journalofaccountancy.com/issues/2015/dec/how-to-admit-new-cpa-firm-partners.html

Mentoring Made Easy for Small Firms
Do you want to motivate and inspire staff, reduce turnover and achieve strategic initiatives? By implementing a mentoring program in your firm, you can unleash your employees' potential and increase their overall efficiency and day-to-day success.
Learn more

http://www.aicpa.org/InterestAreas/PrivateCompaniesPracticeSection/NewsAndPublications/SmallFirmSolutions/Pages/mentoring-made-easy.aspx

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The Long-term Impact of Building an Upside Down Pyramid – Part 1

By Bill Reeb, CPA, CITP, CGMA

The upside down pyramid can be a very profitable approach to workload/capacity utilization for small firms (under $1 to $2 million in revenues). However, it will become a significant barrier to success as a firm grows. As the firm continues to expand, loading more work into the upside down pyramid, it will likely then morph to a more dysfunctional hour glass shape and if not corrected, then to an even shorter and narrower upside down pyramid. As firms progress through capacity models, at the point when the partners and managers start to burn out or the senior partners start seeing a near-term horizon to retire, they commonly either see the error of their ways and begin the required painful shift to establishing a right-side-up pyramid or recognize that the journey is too foreign and uncomfortable to make, so they decide to merge with another firm to let them fix the problem. How and why does this happen?

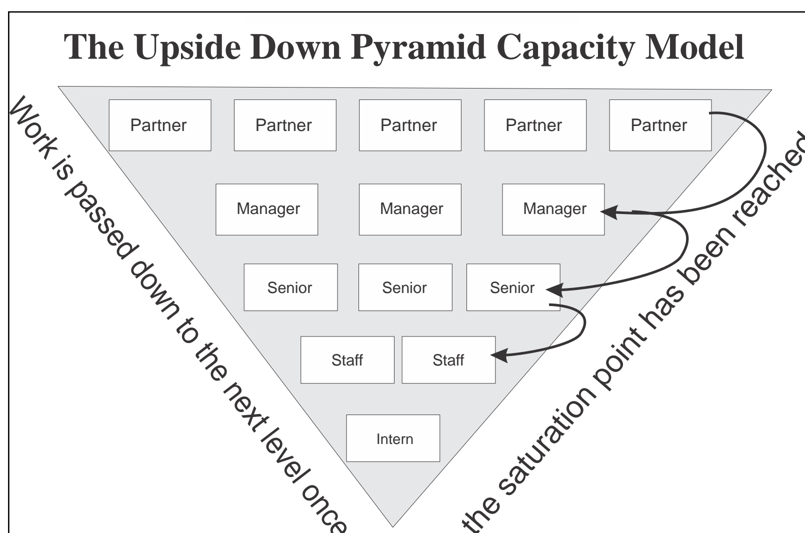
For decades, the vast majority of public accounting firms have had the luxury of experiencing both sustained growth and an expanded scope of service offerings. Whether a firm is first being formed, or it is launching a new service, the workhorse of that operation is either a partner or someone expected to soon become a partner. In the early stages of a new firm or new service offering, there is typically less demand for services than what would consume all of a partner's time. During this incubation period, the partner typically will use his/her untapped time to network, talk to clients and referral sources, and generate more business opportunities while also taking steps to improve the business. With time, demand will likely continue to grow and at some point will max out the capacity of work that the partner can handle. During the early stages of being a new firm or launching a new service, firms tend to default to using these seasoned people to both manage the work, as well as to do the detailed work.

As the client demand grows beyond what a partner can handle on his/her own, the firm (as well as each partner) picks from two common choices for resolution. The first approach is to hire professionals and pass as much work down as possible to free up as much partner time as possible so that the partner can revert back to a more balanced capacity where he/she had time to both do some of the work, but also perform other critical partner-level activities (client relationship management, enhancing the business, improving processes, developing people, etc.). Under the second approach, the partner may choose to remain being the workhorse on the projects coming in. This allows the partner to focus on doing rather than managing, and he/she can also save money by hiring and developing less talented people, since all of the high-level work is horded by the partner. The second option is the one most often chosen, because it is far easier for a partner to take on the title of partner but do manager-level work rather than having to fulfill the entire job of a partner (which also includes client relationship management, creating strategy, working on the business rather than just in it, developing people, etc.). Although this approach where partners do manager-level work can be profitable in the short term, it trades off more desirable long-term profitability, sustainability and leverage.

Since I just introduced the term leverage, let me introduce our definition for the sake of this article. Let's say a partner has a $1 million book and that partner bills $300,000 for his/her time working on that book. If he/she is the only partner working on this book, the way we calculate "leverage," the number would be 3.34 ($1,000,000/$300,000). However, let's take a more realistic look at what typically happens. Let's add "Junior Partner 1" spending $150,000 of billed time on that same book and "Junior Partner 2" billing another $75,000 for his/her work. Since our leverage calculation includes ALL partner time against total book, in this case the leverage ratio would actually be 1.9 ($1,000,000 / ($300,000 + $150,000 + $75,000)). Poor leverage simply means that too much partner time is being spent getting client work done. And although either approach creates bottom line profits, once a partner's time is all eaten up because of too heavy a charge-time load, the firm's growth, client relationship development, internal improvement, people development and strategic change all stop, because there is no time left for partners (the only ones who can do those jobs) to carry out these critical partner responsibilities.

The poor leverage model also carries with it the added dysfunction of either requiring more partners to be brought in early (because a partner maxes out his/her volume of managed client book at low numbers like $600,000 - $750,000 instead of what we look for today being an average of about $1.5 million) or because all of the capacity of the partner is eaten up doing the work, the firm stops growing since there is no time left for the partners to fulfill one of their key roles of business development. Partners with poor leverage simply spend all of their time working in the business rather than on it, which translates to a routine of very little additional profits being made available to support the firm by too many partners managing too small of a book.

So from a workload perspective, how does the upside down pyramid work? Its culture starts with the premise that the lion's share of the firm's income should be generated by its partners and managers. As I stated earlier, when you are smaller, this philosophy is not only logical, but practical, since partners are the first workers in the firm. Therefore, a culture evolves supporting the idea that partners and managers should be very hands-on and involved in the detail work of most client projects. The workflow hierarchy or the utilization of available capacity is a trickle-down approach. Partners do the technical work until they have worked all the hours they can stand, and then the excess trickles down to the managers. Then the managers, while simply mimicking their successful bosses, do whatever technical work is available until they have put in all of the hours they can stomach, and then they allow the overflow to trickle down to the supervisors, with the process continuing in this same fashion down through the lowest level of staff or interns. In each case, regardless of where someone is in the organizational hierarchy, there is <u>low to no priority</u> to keep everyone below them working. Rather, delegating work down through the org chart is more of an afterthought. It is as if the

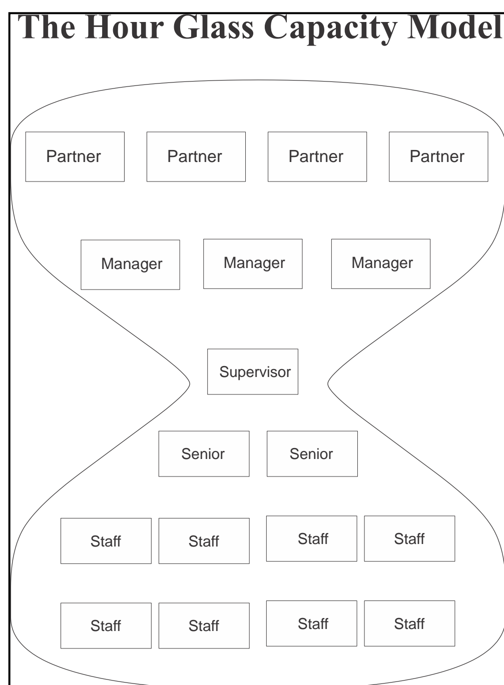


people in these firms believe that the subordinates: 1) are employed to do the work that their superiors don't want to do and/or 2) are considered to be "gofers" kept on standby to provide assistance when needed. By utilizing this capacity model, partners and managers tend to be overworked and staff is commonly under-worked, poorly trained, often performing marginally as a group and generally ignored.

The upside down pyramid will, as a firm continues to grow its top line, harm the profitability and long-term viability of the firm. For example, instead of pushing work down to the lowest level possible, the exact opposite is done. Work is performed by the most experienced person possible. While one could surmise that this approach would garner higher fees (because the work is performed by people with higher billing rates), most of the time that assumption is wrong. For most of the work we do in CPA firms, our total fees are either fixed-in-fact or in-presumption. Obviously, fees are fixed-in-fact when a specific project price was specified. The fees are fixed-in-presumption when we do recurring work, like annual tax preparation, and the client will assume that this year's fees will be within a reasonable range of those charged in previous years (unless the scope of the work changed). So regardless of who does the work, the overall fees are likely going to be about the same. But as mentioned above, the problem is, when you tie up partners doing work managers can do, then partners won't have time to do the partner work that is critical to the firm's long-term success.

While high partner charge hours will likely create excess short-term profits, the partners will be trading off the future of their firms by not regularly spending enough time with clients and referral sources (which is how firms create tomorrow's organic growth), developing their people (which is how firms create tomorrow's leaders and technical capacity), improving business processes (which creates tomorrow's enhanced efficiency), creating and implementing strategy (which generates a more competitive firm in the future), etc. So the key is to get each level of worker in a firm's organization, starting with the partners and working down throughout the firm, to do their jobs – their entire jobs – not just the easiest parts of their jobs. And because we commonly find that firms don't hold people accountable for doing their full jobs, partners end up spending too much of their time doing manager-level work, which then means that the managers will spend too much of their time doing work that should be done by supervisors, and this "working below your level" cascades all the way down through the organizational chart.

Because of the high value put on production at the top in the upside down pyramid capacity model, over time, as the few self-starting, self-teaching, self-motivated people hired move up in the organization, the upside down pyramid degrades into an hour glass shape. Anyone who is any good, or anyone a partner has come to rely heavily upon to assist him/her in taking care of clients, is quickly moved up in the organization. This creates a top-heavy organization with almost all of the work being done by equity partners, non-equity partners and maybe managers. The constriction in capacity in the hour glass model is typically found at either the manager level or the supervisor level with the firm (sometimes at the senior level). This means that even when the more senior people try to push work down, there is truly a huge capacity shortfall at one or two levels in the firm, which then generates reverse delegation (the phenomenon where work is delegated down and shortly thereafter, delegated back up because there is



no capacity available to do the work and it is perceived as too complex to skip down multiple levels). This puts even more pressure on the top to perform. It is common to see firms where the top two or three levels in the firm have to work more hours each year to maintain their current standard of living, because as expenses keep rising, that means the top levels need to bill more and more time just to stay even.

In both the upside down pyramid and hour glass capacity models, a cultural hurdle to overcome, which for many is one they are unwilling to face, is realizing that with each promotion to a higher level in a CPA firm, it becomes more important what you do with your non-charge hour time than your charge hour time. Don't misunderstand us. We are not saying that charge time doesn't matter. Rather, at the lowest levels in the firm, people should be charging almost all of their time, because doing client work should be all they do. With each promotion, a little less of the job is about doing the work, and a little more of the job is about managing and developing others. By the time you get to partner, a good charge hour range is about 900-1,100, but that presumes that there are very specific firm-wide goals and objectives driving the focus of a partner's remaining 1,200 to 1,500 hours.

The cultural clash that occurs when partner and manager production is so highly valued is that critical objectives like spending time developing others are considered low-value work. This is supported by comments such as, "If I were to give this work to someone below me, I would have to spend so much time supervising them on the project that it is just quicker to do it myself. Besides, I simply don't have the time to do this." Our response: "Both the roles of partner and manager are based on the philosophy that you are supposed to get the work done through others." As a manager, that title is exceptionally descriptive of the job – to manage. Otherwise, the title would be "doer." So we suggest the next time you hear yourself or others utter words such as, "It will take too much time to train my people to do this," then stop right there and remind yourself, "Hey, while it may take longer, my job is to train them so that they can do this work. And if I don't train anyone to do what I do, I will likely end up having to work more and more hours just to make the same amount of money."

By the way, another classic reaction from both the upside down pyramid and the hour glass capacity models is that employees rarely get enough feedback and coaching on their work, partially because of the lack of time again. Instead of the reviewer sending back a list of errors for the originator to fix, the senior people just efficiently correct the project so they can get it out the door, but ineffectively walk away from an opportunity to train their people to make them better. Over and over, these two capacity models support the inaction of developing a better, stronger, faster staff, putting more and more pressure on the partners and managers to perform the work, which eventually creates significant problems for firms to overcome, including workload compression and the lack of profitability, sustainability and succession.

We will pick up here for the next articles as we start talking about steps to take to fix either the upside down pyramid or the hour glass capacity models. Until we see you again, we wish you a happy, healthy, prosperous holiday season and new year!!

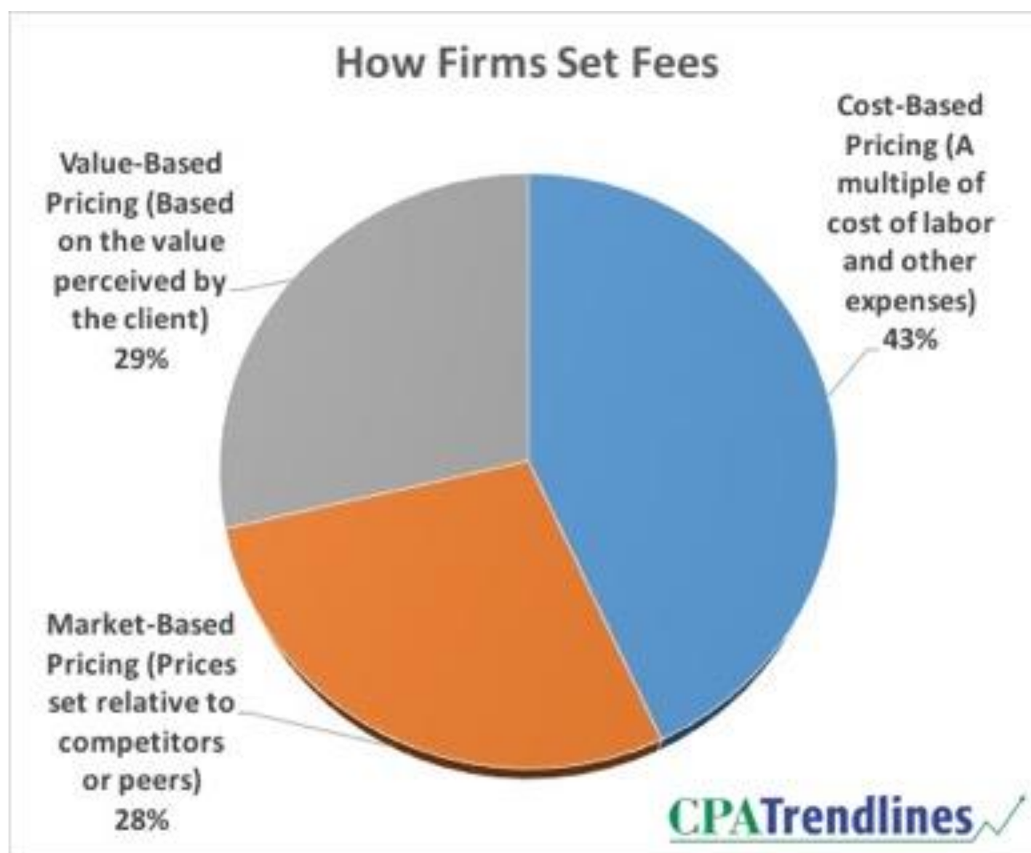
Chaos in Tax and Accounting Pricing

Survey shows consistently inconsistent strategies in the profession

By Rick Telberg
CPA Trendlines

If there's one especially surprising result from the new [CPA Trendlines Price Strategies and Trends Survey](), it's that over a third of responding accountants say they lack a consistent strategy for setting rates. To put it another way, they have a consistent strategy of adjusting rates as necessary to accommodate the needs of both the CPA firm and any given individual client.

Certain words came up a lot in the respondents' anecdotal explanations. *Adjust, blend, hybrid, combination, adopting, moving, shifting …* What these CPAs had in common was a tendency to set rates according to, well, whatever works.



As Macushla Wiedorn put it, "I start with prices, and adjust according to difficulty and ability to pay." That, of course, can be considered a strategy, one by no means inconsistent or uncommon.

It was also surprising to find little movement toward value pricing, which was once touted as the pricing strategy of the future. Apparently, the future isn't here yet. In 2008, the same survey found 27 percent of respondents using value pricing. Now, seven years later, the percentage has shot up to 28, which isn't much of a shoot.

Why the stasis? Two reasons: One is just plain reality. When the rubber hits the road, it's the client who decides what's fair and what's the last straw. Paula Allgood said it well, "Our philosophy is value-based pricing, but we have an increasing tie-in to the costs incurred in real life."

The other reason is that the use of value pricing isn't as static as it looks. It's just that some CPAs are moving toward value pricing while others are moving away from it. From Annie Driver, we heard, "We are in transition from value-based to cost-based under new ownership." But from Ray Wasser, we heard, "We are in the process of adopting a value-based pricing model." And then from Dean Holland, we heard: "I blend cost-base pricing with value pricing. I use cost basis as a base and adjust, based on the value of the project."

The transition in either direction isn't an overnight switch. It's a process that balances the costs of doing business for the CPA and for the client. The process of transition – or really, in many cases, the switch to what works – accounts for a lot of the blending, combining and adjustment.

Perceived value is a crucial consideration, but by the very nature of perception, value is in the eye of the beholder. The theory of value pricing depends on the value the client perceives, though it isn't always that simple. "The value is not so much perceived by the client as it is by us," commented Clayton Tuggle.

If there's a fatal flaw in value pricing, that's it: the client just doesn't understand the work of the CPA and the educational preparation behind the practice of accountancy. "I really have no idea what value a client would perceive," said a CPA named Pamela, who is hoping to increase her fees slightly this year. "They typically have no idea how we do what we do. So I keep my prices on the upper end of middle with my competition."

Bottom line, it's a matter of fudging up the price that works. One respondent said it's "an inexact science," and another went even farther, saying "pricing is an art, not a science."

Who'd ever think that it's in accountancy that art meets science? But there we are.

The survey remains open as we continue to gather more in-depth data.
Join the survey. Get the results.

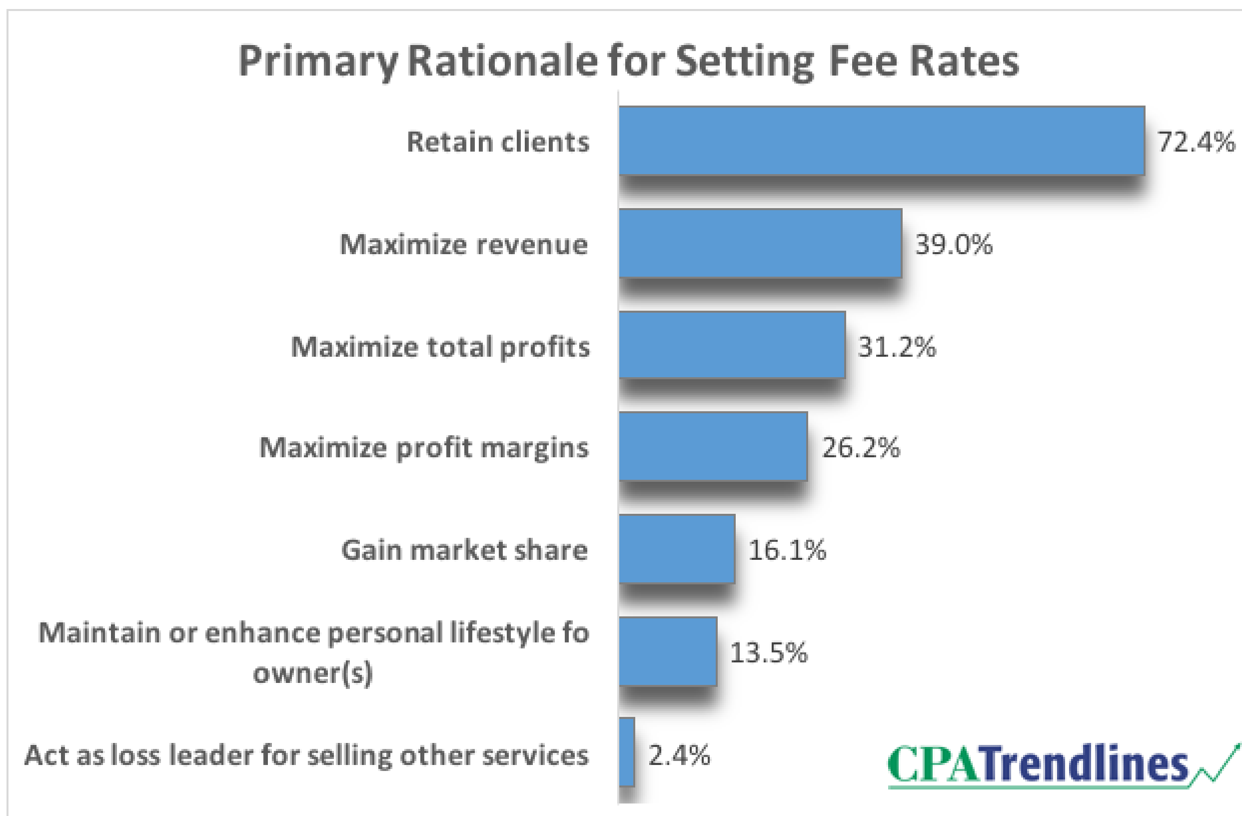
Rule 1: Client Retention

Raising rates is risky, but so is ***not*** raising rates. You have to raise them right and at the right time. And not on a willy-nilly whim. You need to think about it. You need a rationale.

In search of reasonable rationales – rationales that ***work*** – *CPA Trendlines* is asking practitioners for the rationale behind their pricing strategy, and they are being generous in their response. Most say that strategies were lacking or could be improved.

Generally speaking, the primary consideration – primary by far – is to retain the client. Over 72 percent of more than 500 respondents list that as one of their considerations. What good is a lofty rate if the client leaves for someone cheaper? A nice high price hurts all the more when you see how much money you're not making. Ouch and ouch again.

Make that three ouches, if you think about losing not just a client but a ***loyal*** client. Rita Kettl, a small firm CEO who hopes to raise rates moderately this year, expressed that sentiment, "Would like to increase pricing," she wrote. "However, client base is very loyal and raising pricing would drive many clients away."



Loyalty is a two-way street, so it's not to be abused. On the other hand, there's little satisfaction in making less than you might. That brings up the second most common concern – maximizing revenue, a rationale for 39 percent. Almost as many, 31 percent, set rates to maximize total profits. Next-most common was the desire to maximize profit margins.

Patrick Howard, whose firm figures on significant increases this year, revealed the balance they seek. "We try to keep our realization rate at 80 percent, without excess client losses," he wrote.

At first blush, one would wonder why anyone would ***not*** want to maximize revenue, profit and margins, but there's a lot to consider. Yes, retaining clients and maximizing moolah were the top rationales, but 16 percent figure in the advantages of using rates to gain market share. An honest 13.5 percent admitted that they determined rates with the objective of "maintaining or enhancing the personal lifestyle of owner(s)." And 2.4 percent – desperate, aggressive and savvy – occasionally lowball a rate as a loss leader for selling other services.

"BE FAIR TO CLIENTS," shouted John L. Hess, who heads up a small practice of under 10 people. He isn't alone. Ken Escobar states his principle rather clearly, "Fair value to my clients." Georgeann Guagliardo says about the same, "Fair to both parties."

However, fairness depends on a few intersecting factors and, as with loyalty, what goes around comes around. Value is one of those factors. One respondent said, "Get clients to realize value." Another said, "Provide maximum value to clients."

"We value price before the engagement begins," said Dan Allen, whose firm uses a value pricing base almost exclusively. "No disputes/collections issue, especially with use of the engagement letter."

“We approach pricing with the customer lifetime value in mind,” said Daniel Morris. His firm is “all value based, but we do use contingent and phasing of projects. We don’t have billing rates. We price for purpose.”

That sounds fair, profitable and likely to retain clients – and is, apparently, a minority view.

Rick Telberg is founder and CEO of CPA Trendlines, at cpatrendlines.com*, a business intelligence service for tax and accounting firms.*