Public Practice E-News
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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
The previous two articles in this series have covered realization, leverage, net income per partner, business generated and Capacity Budgeting™. In this third and final article of the series, Bill Reeb discusses a tool used to determine a reasonable employee return on investment (ROI) by addressing what a firm should expect as a reasonable amount of billings from an employee at a specific staffing level given his/her current pay (salary plus overtime). The billing worksheet is one of many tools used to help pinpoint a firm's performance and compensation issues. Using the worksheet can identify whether charge rates, pay rates, hours utilized and realization all make sense in a bottom-line context. Just like every tool, using it can assist you in asking better questions, but there are many variables in play that determine a final statistic or metric.
Read Reeb's commentary
Link to Bill Reeb article

The Five Factors Propelling Growth at CPA Firms Today
CPA firms currently seem to be divided into two camps: Those gunning for growth with innovation, professional development, and strategic acquisitions of top talent and books of business – and those that aren't. This article looks at results reported in the annual Rosenberg MAP Survey for 2015-2016, which is a new study of almost 400 small and mid-sized firms. The study presents both good and bad news to consider.
Rick Telberg takes a closer look
Link to Rick Telberg article

Top Three Accounting Marketing Tactics for 2016
Marketing strategy is one of the critical factors separating high-growth accounting firms from low-growth firms. However, it's not necessarily the amount of money firms spend that distinguishes winners from losers when it comes to marketing strategies. Instead, it's how they choose to invest their marketing dollars.
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Learn more and nominate a rising star.
http://secure.tscpa.org/rising_star/nominationentry.asp
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Five Keys to an Effective Client Acquisition Strategy
When firms embark on a client acquisition strategy, they often spend time and money and get minimal results. What makes a strategy effective? To be effective, a strategy needs five characteristics.
Learn more
http://www.accountingweb.com/practice/clients/5-keys-to-an-effective-client-acquisition-strategy

Q&A: Pricing Options That Boost Profits
In this Q&A session, author and consultant Ron Baker provides an in-depth look at why firms should offer different pricing to clients. He says value pricing includes offering different options, which can simultaneously increase client satisfaction and firm profits.
Read the Q&A session
http://www.journalofaccountancy.com/issues/2015/sep/cpa-firm-pricing-options-boost-profits.html

Why Does Any Business Become Your Client?
Do you know why prospects choose to become your clients? In many cases, clients simply walked in the door and said they needed help, and your firm was able to support them. Why did they choose your firm? When you don’t know why people use your service or their specific

needs, you don’t know how to purposely market to those factors to draw more clients in the future.
Learn more
http://www.accountingweb.com/community-voice/blogs/martin-bissett/why-does-any-business-become-your-client

Recruiting Strategies in a Ridiculously Tight Labor Market
It's no secret that the CPA labor market is extremely competitive these days. Despite the challenges firms of all sizes face when it comes to finding and keeping talent, they are making great strides in recruiting college graduates and experienced professionals alike. These firms recognize that what worked in the past may not resonate with today’s recruits. There are strategies that any firm can leverage.
Learn more
http://www.aicpa.org/InterestAreas/PrivateCompaniesPracticeSection/NewsAndPublications/ThePracticingCPA/Pages/tight-labor-market.aspx

Seven Ways CPAs Provide Value to Their Clients
In most professions, establishing your worth is the value proposition. How do you provide value? When you become your clients’ go-to person for financial decisions, they have compelling reasons to refer you to others. This article discusses seven ways you provide value.
Read the article
http://www.accountingweb.com/practice/clients/7-ways-accountants-provide-value-to-their-clients

How CPAs Can Assist in the Event of a Cybersecurity Attack
Cyberattacks are becoming commonplace. Find out how CPAs can help clients evaluate potential cyberrisks, create a strategy in the event of an attack and, in the event that one occurs, mitigate the damage.
Get the tips
http://blog.aicpa.org/2015/09/5-ways-cpas-can-add-value-in-the-event-of-a-cybersecurity-attack.html#sthash.cjuCpmz5.S35F6NPZ.dpbs

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Metrics: Their Value is in Creating More Questions – Part 3

By Bill Reeb, CPA, CITP, CGMA

In our previous two articles, we have discussed realization, leverage, net income per partner, business generated and Capacity Budgeting™. We will pick up in this article working through a tool we use to determine a reasonable employee return on investment (ROI) by addressing what a firm should expect as a reasonable amount of billings from an employee at a specific staffing level given his/her current pay (salary plus overtime). Just like every tool, using it should help you ask better questions, but it doesn’t answer them, as there are many variables in play that determine a final statistic or metric.

The tool we use to take a look at employee ROI is the billing worksheet.

The Billing Worksheet

The billing worksheet is one of many tools we use to get a feel for our clients' performance and compensation issues. As you read through this explanation, please keep in mind that this is simply a way to begin looking at the ROI provided by each of your people, especially at the lower levels, where the main focus should be on their production as compared to managers and partners where, for example, their main focus should be on client management, people management and the like. What we're trying to do here is to see if charge rates, pay rates, hours utilized and realization all make sense in a bottom-line context.

The fallacy of how most firms set billing rates for their people is that they take someone's pay, multiply it by four or five, divide it by 2080 (40 hours a week) or some other number and establish a billing rate. To us, that formula has decreased substantially in its relevance over the years. This is because all of our people don't do the same kind of work and the work itself has built in efficiencies and/or inefficiencies. For example, consider a firm's top, highly talented audit managers producing 1,600 hours of billable work, tax managers with similar skill levels producing 1,400 billable hours and similarly skilled business valuation managers producing 1,100 billable hours. If they all make about the same amount of money, they should have different billing rates to make sure that, at the end of the day, they can return the same ROI expected by the firm.

If everyone has the same billing rate, you have not factored in the natural efficiencies/inefficiencies rooted in the work they are doing. Using our example above, those audit managers will almost always be the darlings of the firm, because they will bill more revenue. However, the "one rate applies to all" philosophy is actually sabotaging the other managers in the firm.

Continuing with our example, let's consider that the firm does a lot of large audits where the auditors are out of town a great deal. Doesn't it make sense that while the auditors are traveling and in the field, almost every minute they work is billable (and therefore, probably earning a lower realization since no one can really deliver eight hours of efficient work every day)? Now consider the tax managers. They don't travel and they typically work on smaller projects. Because of the start and stop time between each project and the fact that they have so many projects, doesn't it make sense that they can be working as much as the auditors in this example, but not be able to capture the same amount of billable hours (and because they are not onsite with the clients, their inefficiencies turn into non-charge time and, therefore, they tend to have a higher realization)? Finally, think about the business valuation managers. Because that type of work is often feast or famine, firms often pay to have a specific level of expertise that is sometimes underutilized at various times of the year due to the timing of projects. For this group, you might find that those managers would be lucky if they can amass more than 1,100 chargeable hours no matter how hard they work.

The point is … everyone should have a fair chance to earn the appropriate ROI for the firm. For that same reason, people who work in multiple areas of the firm, we believe, should have multiple billing rates, with each rate appropriate for the type of work they are doing. Remember, charge hours are one variable, realization is another, the billing rate is a third, but in the end, we believe it is all about total expected billable dollars. Therefore, you have to consider what is reasonable given the work being done for each of those variables. We use the billing worksheet to help assess where changes need to be made.

For this discussion, we are going to use some assumed numbers to illustrate the process we use with the billing worksheet. The numbers in the illustration are simply sample numbers used to illustrate concepts, so please don't get hung up on them if they are out of line with your marketplace or expectations.

As introduced above, the billing worksheet focuses on five variables:

1. Charge hours,
2. Billing rates,
3. Realization,
4. Annual salary, and
5. Multiplier

Manager Example

		Billing Rate Analysis					
	Actual Charge Hours-2010	Current Billing Rate	2010 Actual Realization	Salary	Estimated Multiplier	Expected Revenues Based on Actual	Estimated Revenues Based on Est. Multiplier
Manager	1,500.00	$ 125	90%	$ 90,000	2.5	$ 168,750	$ 225,000

Estimated Billing Shortage (Overage)
$ 56,250

Calculated Targeted Hours
2,000

Current Earned Multiplier
1.88

Calculated Billing Rates
$ 167

In this example, you can see that we've chosen a manager with 1,500 actual charge hours from the prior year, whose billing rate is $125 an hour with 90 percent realization. He/she is being paid $90,000 a year in our example. This pay figure is typically the base pay plus overtime pay. It does not include performance bonuses/benefits, such as health insurance, life insurance, retirement plan, profit sharing and the like.

In this illustration, we use 2.5 (two-and-a-half times) as a multiplier. We multiply this times the compensation paid to determine what the expected billed revenues should be from this person. In this sample case, 1,500 actual hours billed times the actual hourly rate of $125 an hour, reduced to 90 percent actual realization, comes up to $168,750 actual net production generated by this $90,000 a year person (before other bonuses and benefits). Now, compare that performance to our expected "return on investment" calculation. In this case, with a salary of $90,000 and a 2.5 multiplier, it indicates that a reasonable ROI for the firm with someone making that amount of money should result in net production of $225,000. This means that when you compare our expected ROI against the actual performance of this manager, we're looking at a $56,250 shortfall in billings for this person. That's $56,250 of profit that could have gone to the partners or invested in the firm that is lost forever. In other words, $225,000 (expected ROI) less actual production of $168,750 (hours times rate times realization) creates a shortfall of $56,250.

Now, let's take a look at some of the questions this information should bring to the surface. Could you make up this difference by making that person more chargeable at his/her current billing rate and realization? Theoretically you could, but based on the spreadsheet, you'd need to get 2,000 charge hours out of him/her and that is not realistic unless you want the manager to pad his/her hours. The problem is that if the manager pads hours, the 90 percent realization rate wouldn't be attainable, so he/she will still be under-performing. However, if this person isn't well trained, improving his/her skills through training could be the fix for the realization.

If we back into it, what this model points out is that your actual multiplier for this manager is currently 1.88 times salary, quite a bit off from the 2.5 times salary for estimated revenues that we used earlier. If you would decide to stay with the lower multiplier here, you would be saying that given the work this person is doing (because of its other value to the firm, like taking care of great referral sources, etc.) you would be willing to accept a lower ROI on his/her work.

Think about it. Using $90,000 for base pay, you'll still need to cover payroll taxes, insurance, other fringes, plus some share of overhead, and then what's left, if anything, goes to the partners. So consider what an extremely low multiplier will actually be doing to the bottom line with respect to this employee and the contribution to operations. It will actually be taking money away from the partners or areas that need additional investment within the firm.

Of course, there could be circumstances where this current level of ROI could make sense and even be profitable for a specific employee doing a specific job. For example, consider an auditor who works on some select non-profit clients. These clients could have been offered special pricing as a marketing choice of the firm to position the firm to be in front of prominent people in the community. (This is not an excuse for poor performing non-profit work. It is just an example of a situation that should be managed and limited – and your firm needs to actively capitalize on being in front of these folks). In this case, especially if you know the employee managing the non-profit work is an excellent performer, you may choose to make his/her multiplier 1.5 or some other lower than normal number for that position, because you know the reason for the lower billings is due to your firm's strategic choice, so you are willing to make less ROI on this employee (or better said, you recognize that you are making a fair return using a lower multiplier, because of the discount on fees you have passed onto the client).

As an alternative to status quo or increasing charge hours in this illustration, you could get back to the appropriate ROI on this manager by bumping up his/her billing rate to a rounded $170 an hour. This would provide a reasonable ROI for the partners. Now, you may be thinking that the market won't bear that rate. If the market won't bear that hourly billing rate for this person, what we find is that the market also won't demand that you pay this person at the salary you are currently paying either. We have not seen a situation where a firm had to pay high dollars for staff while their market would only pay low dollars for the work. If that is the scenario you believe you are operating under, to us, that doesn't make sense. In rural markets, people cost less and fees are less. In large cities, people get paid more, but the market also allows for those salaries to be passed on through relatively higher fees.

The next question to ask is, how efficient are your work processes? How well trained are your people if your overall efficiency is off? And of course, whose fault is it if the people aren't adequately trained? It all goes back to what you value as a firm and what you're willing to pay for.

So you have four variables to consider.

1. Are you paying this person the right amount? This is the least flexible value, though it could impact how you offer future raises and bonuses.
2. Are you using a billing rate that makes sense with what you are paying this person? Often, the biggest part of the problem lies in this variable.
3. Next, you have to ask if this person is efficient doing his/her work. Often, this is a combination of training opportunities and getting partners and everyone else into the routine of delegating work as they should be doing.
4. Are you getting a reasonable amount of charge hours? Often, this is a combination of performance expectations, poor delegation from partners, managing the pipeline and scheduling, etc.

Many times, this billing worksheet points out a number of problems the firm needs to address simultaneously for you to create a reasonable return on your people investment. In other words, most firms want to put all of the blame on poorly performing people and projects when in fact much of the problem lies in poorly performing partners and managers not selling the work at the proper levels, not delegating the work appropriately, and not training those below them how to do the work.

On another note, we'd like to address a common objection we often hear when we suggest that you need to raise staff and manager rates. It is, "Our partners only charge ___ – fill in the blank here, say $225 an hour, for example – so how can we charge that manager out at $170 an hour? The answer is far simpler that it first appears. In most cases, based on our experience, the partners aren't charging high enough rates to justify what they make either. You want billing gaps between each level of person within your firm. If the rates for partners were where they should be, it will be easier not only to bill appropriately for managers, but also to move some of the work off the partners' plates to their people, because the clients would see a true price differential between partner rates and the managers' rates and so on, down the line.

You may have heard us say this before – whenever you raise rates, you rarely see enough client attrition to offset dollars earned from the new, increased billing rates. In fact, you usually end up net ahead, even with client attrition. If you do lose a client or two, it just means that you have more time to devote to managing the business, working with the remaining good clients and developing your people, all of which will pay far greater dividends to you in the long run.

In summary, the odds are that by utilizing and completing this worksheet, you're going to find out that there are several people whose billing rates don't make sense, since billing rates should be a function of pay, not position. You will also likely find out that several of your people who you have considered to be billing stars are actually not really out-performing some of your average people when you take into account pay differences. And finally, it is not uncommon for our firms to find, based on the way they are utilizing some of their part-timers (they tend to involve part-timers in too many non-chargeable activities), that part-timers are killing them profitability-wise.

Multipliers

Now, at this point in the conversation, the next question we get is, "What multiplier should I use?" There are no set-in-stone rates or range of multipliers that you need to use, but a starting place might be the following list:

3.25 – 3.50 for paraprofessionals

3.00 – 3.25 for staff

2.75 – 3.00 for seniors

2.50 – 2.75 for technical managers

2.25 – 2.50 for supervisory managers

2.00 – 2.25 for principals

You can see that multipliers range all the way from less than 2.0 for a principal, on up to 3.5 or so for a bookkeeper or paraprofessional staff. These ranges are based on surveys we've done of client firms. Certainly, some use higher and a few may use lower multiples; these ranges are a good starting place for anyone interested in doing this analysis we just reviewed with you.

Now keep in mind, if this is your first time going through this analysis, consider starting at or near the lower end of the range or perhaps even a tad under the low end, and then easing into the changes over a year or two as you go forward. In other words, if you find that you need to raise your rates, you should not feel compelled to do it all in one year. Try to start moving them up so that over the course of two to three years, they're up to the right place. Don't try to make up for 10 years of previous, unprofitable practices by trying to fix it all at once.

Another point that's worth reiterating with regard to the use of this billing worksheet tool is that it should generate some questions that need to be asked. When you find out there are people not performing based on their numbers and a reasonable multiplier, it's time to then ask the questions: "Why? Is it just them? Is it how we're interacting with them? Is it how we're assigning work to them? Is it the fact that we have them tied up in a bunch of administrative duties?" Don't jump to conclusions. Remember, the fish stinks at the head, so once you uncover a problem, recognize that the partner and manager group are very likely playing a large role in perpetuating the problem, especially when the problem is recurring or is seen across numerous people.

Use Metrics as Management Tools

For those who would like a downloadable copy of the billing worksheet, just visit our website at www.successioninstitute.com, register (it doesn't cost you a thing), and search for Billing Worksheet – General and you can download it.

This concludes our three-part series on metrics. Obviously, there are many more metrics to consider. However, the bottom line is … use them as management tools ONLY as they are great at creating questions in your mind to answer, but taken as a number at face value, they often provide misinformation or motivate people to jump to erroneous conclusions.

The Five Factors Propelling Growth at CPA Firms Today
And Why So Many Firms Are Falling Behind

By Rick Telberg
CPA Trendlines Research

The nation's CPA firms seem to be divided into two camps: Those gunning for growth with innovation, professional development, and strategic acquisitions of top talent and books of business.

And those that aren't. They're coasting towards the exits, holding tightly on the purse strings of new investments in people, technology or new clients. This group is quietly leaving the competitive battlefield, content to gather their winnings from a lifetime of hard work and go home. Maybe someone will buy up their small, aging books of business. But it won't amount to much. From a coldly competitive point of view, they won't be missed.

The firms in the first group, on the other hand, are the ones reshaping the profession for the future. They're forging new trends, rewriting the CPA rule book, redefining the business. They're the firms to watch and aren't hard to spot. They also happen to be making waves in the market. The annual Rosenberg MAP Survey for 2015-2016 shows how.

The new study of almost 400 small and mid-sized firms presents both good and bad news – and more of the latter than the former. The full report is available from *CPA Trendines* at store.cpatrendlines.com/shop/map-survey.

The good news: CPA firms' revenues and profits are increasing.

The bad news: The increase in revenues is less than last year, and a lot of it is only due to mergers. Growth was slowest for the smallest firms. The increase in income per equity partner is especially sluggish. Most worrisome is the finding that organic growth – which is to say *real* growth not generated artificially by mergers – was actually a bit lower than last year, dropping from 5.2 percent to 4.7 percent.

So is this really the end of a golden age for the profession? I don't think so. Our data at *CPA Trendlines* suggests a paradigm shift in CPA firm economics. The new future-ready firm is nimble, technologically advanced, client-centric, and diligent in recruiting and developing top talent.

To be sure, mergers account for across-the-board growth, but even merger-driven growth is slowing. Mergers now generate 30 percent of top-line growth, up from 22 percent last year. And that's especially true for firms with revenues under $20 million – the up-and-comers. Larger firms are seeing a radical decrease, from 25 percent down to 16 percent, in merger-related revenue growth, a sign perhaps that the merger frenzy is topping out. Larger firms, as well, are growing organically at more than 7 percent, well above the rates at mid-sized and smaller firms.

A growth rate of 7 percent isn't too shabby, but it falls well short of spiffy. It's certainly better than in the darkest days of the recent recession. What's worrisome is that the rate declined even as the economy grew. Apparently, there are other factors at work here.

Anecdotal explanations from CPAs give us some likely explanations. Here are the four leading factors.

1. **Baby Boomers** – The once-burgeoning baby boomers are getting boomed out. They're retiring and as they fade off to Florida, they shut down or sell off their business. Every time they do so, a CPA firm loses a client, generally one that has been growing for several decades. Paradoxically, baby boomers in the accounting profession are reluctant to retire. They've gotten good at what they do, and they've learned to love what they do. Their clients have become their friends. So why retire at 65? They might slack off a bit, but they often want to keep working until they're 70 or more. The get up and go of younger days now gets up and goes golfing. The firm loses some of its hustle. A decline in hustle means a decline in growth.
2. **Mergers** – If you've ever been a principal in a merger, you know what work it is. A merger can generate the appearance of revenue growth, but the fact is, it distracts people from the organic growth of finding and developing clients. More mergers mean less organic growth.
3. **Labor Shortages** – The accounting profession suffers a worsening shortage of professionals. With firms short on staff, efforts to expand clientele just don't seem worth the effort. In fact, expansion can be counterproductive if it spreads staff too thinly.
4. **The Economy** – The recovery from the recession isn't all it's cracked up to be. Some companies are booming, yes. Wall Street is doing fine, but Main Street is still hurting. Many regions are still in the economic doldrums. The impact inevitably hits CPA firms, especially the smaller ones.

Profits increase as income per partner lags

If revenue growth is slow, income per partner is barely better than stagnant. The Rosenberg MAP survey finds that CPA firm profits are rising just 2.6 percent, to about $392,000. The survey attributes the increase to modest billing-rate increases and the organic growth of revenues, but a host of other influences is holding profits back. Among them are: realization, fees per partner, fees per person, staff-to-partner ratios and overhead spending.

The Rosenberg MAP survey has been tracking an interesting trend over the last eight years. Up until 2006, income per partner growth always exceeded revenue growth. In 2007, something happened. Ever since then, revenue growth has exceeded income per partner growth. How come? What's changed? The survey takes a few stabs at explanation.

1. **Baby Boomers** – Yes, it's the generation that just won't quit. In this case, it won't quit the firm. Partners stay way beyond the traditional age of retirement. As new partners come on board, more partners mean less profit to each.
2. **Mergers** – Mergers tend to generate higher revenue numbers, but a merger also generates higher partner numbers; that is, more partners to share the revenue, driving down the average.
3. **The End of the Golden Age** – Some say the golden age of public accounting occurred with the advent of the Sarbanes-Oxley Act of 2002. The stiffer audit requirements created the highest demand for CPA services in the history of the profession. The increased demand

trickled certain services down to smaller firms. As soon as the profession caught up with the new demand, the golden profits slacked off.

4. **Intangibles** – The survey identified "intangible" as increased costs without a direct and immediate impact on revenues. These included:

   - Less effective management of people issues (recruiting, training, mentoring, leadership, etc.).
   - Retirement of senior partners causing loss of invaluable experience and talent.
   - Insufficient leadership development.
   - Higher salaries without parallel increases in billing.

The new Rosenberg MAP Survey concludes that these and other unmeasurable intangibles are the dominating force behind the slowdown in revenues and profits.

At the same time, the survey reveals a few significant things about the state of the accounting business – that growth and profit per partner are growing at a negligible rate and that intangible people issues are becoming painfully tangible, for example. More subtle truths also emerge in the gimlet-eyed observations of those who advise CPA firms.

These truths are not self-evident, but with a little analysis, five trends emerge vividly, trends impacting CPA firms large, small and middling. So it's worth having a look.

1. **Aging infrastructures in crisis** – Roman Kepczyk of Xcentric says his company is often called in to improve workflow and efficiency, especially through better use of technology. "Firms overall remained cautiously optimistic, with those that were more specialized/niched seeing solid leaps in growth in both personnel and revenue. These firms brought us in to direct their investments in upgrading their infrastructures, focusing not only on the physical IT components, but in optimizing their internal production processes with the applications they had in place."
2. **Executive leadership heads for the door** – Rita Keller of Keller Advisors perceives too little focus on preparing firms for the future. Technology is lagging, she says, and the leaders who are moving up aren't as good as the ones moving out. "While there has been a great deal of concern about long-time CPA partners beginning to retire and taking with them a great deal of experience and wisdom, there has also been many long-time, extremely knowledgeable and valuable firm administrators and COOs heading down the retirement path. Transition of client relationships is extremely important; so is the transition of CPA firm management knowledge."
3. **The economy helps some, hurts others** – Jeff Pawlow of The Growth Partnership is concerned about expansion rates among CPA firms remaining meager despite the general economic growth. He said the reason is that the growth of certain client companies has been to the detriment of others. "We are playing a zero-sum game. We have a number of clients that grew well above the average over the past several years. The challenge at a macro level

is that their growth is coming at the expense of other firms, not because the market is getting larger."

4. **Staffing shortage impairs expansion** – Chris Frederikson of 2020 Group says the past 12 months have been good for CPA firms and their clients. The problem is lack of qualified professionals. "The single overwhelming challenge for firms in the last 12 months has been how to get the work done and at the same time, provide world-class service. We have recently seen firms turning away desirable clients for lack of capacity."

5. **Mergers, consolidation and shakeout** – Gale Crosley of Crosley Company observes that mergers are having a number of impacts that go beyond firms getting bigger. She sees mergers suppressing organic growth, because the merger process puts real growth on a back burner. She also sees a disruption in the international networks and associations that sustain the quality of the profession and its standards. "Many dynamics are taking place in international associations, networks and alliances. Firm mergers usually cause post-merged firms to abandon one of their two affiliations. This impacts association and network strategies as some of their anchor firms go away and heretofore exclusive geographies become available."

Rick Telberg is founder and CEO of CPA Trendlines Research, at cpatrendlines.com, a business intelligence service for tax and accounting firms. The Rosenberg MAP survey cited in this article can be purchased in full at https://store.cpatrendlines.com/shop/map-survey/.