

CPA Practice Management Forum, Track Your Key Profit Drivers, (May 1, 2011)

By Shannon Vincent

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How can an accounting firm improve its profits? In many cases, the answer is hiding in plain sight.

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We at the ReNew Group are amazed (and surprised) at the lack of attention, priority, and focus that firms give to tracking their own key financial metrics. The old adage that the cobbler has the worst pair of shoes regularly applies to accounting firms. We often see low productivity, rotting work in process (WIP), underperforming clients, and astonishing write-offs. Further, there is a material lack of attention even at accounting firms despite their having purchased comprehensive practice-management systems.

What gives? It could be busyness, fear, low self-esteem, or just plain old apathy.

There is a solution. Our view is that your firm needs someone who commands the Six Key Profit Drivers:

1. Productivity
2. WIP
3. Average hourly charge rate
4. Write-ups/write-downs
5. Accounts receivable (A/R)
6. People leverage

Typically, clients call me in because there is something wrong. They think they lack vision for the firm and want to know what they can do to get their people to engage. Or their staff feels super busy and stressed out all the time. The first thing I do in my approach is perform a financial assessment; namely, I talked to the client about the key profit drivers, starting with productivity by team member. I sit down with the client, and we take a look at the key metrics. Typically, firms know they are underperforming, but they don't know why.

Their problem is not as nebulous as lack of vision, but something much clearer. In most firms, even if they had to *hire* someone to do only *tracking* of their numbers, they would see returns.

Where the focus is

Most firms focus on productivity (what some firms refer to as "utilization"). The Managing Partner or Partner Group says, "Give us 80 percent and we'll be happy," which seems reasonable enough. Unfortunately, in our experience, this singular focus has deleterious consequences of the following nature:

- Accountants migrate to easy jobs to get their time on the clock (easy jobs may not be the most profitable jobs).
- Average hourly charge rates go down.
- Team members are focused on time, not effectiveness.
- Team members pad their hours.
- There is no focus on job turnaround—no incentive to finish jobs. Accountants hop from one job to another to get their time budgets. Result: long turnaround time, unhappy clients, client attrition, and apologetic write-offs.
- Write-offs go through the roof.

Profit drivers and you

The solution is to focus on the Six Key Profit Drivers. Please note, I have had many arguments with many partners, so let me pre-empt that here: You can't focus on just a few profit drivers; a firm needs them all. Think of trying to drive your car with only two tires inflated.

All Six Key Profit Drivers need to be implemented at once; however, I start with productivity, then WIP, and so on down the list in rapid succession. I begin with showing a firm where its productivity is. My first questions for a client are:

- Do you or do you not have access to the information?
- Are your team members given expectations?
- Does each team member know that for the 2,200 hours he or she is going to work during the year that 70 percent of those hours (or whatever number is appropriate) are going to be good, productive hours?

Then, the firm needs to ask itself:

- Are we setting the proper expectations?
- Are we tracking them?
- Are we looking forward?
- Does each team member have a schedule that allows him or her to look forward for a week to a month out?

The key to tracking the numbers is getting someone who *has* the time and understanding to track the numbers. We recommend that it be the director of operations or business manager. The process can be simple in a firm that is ready and willing to implement a culture of self-accountability. Our definition of self-accountability is that team members are given clear metrics and objectives, and it is their responsibility to report back to their supervisor regarding their results.

But you can't focus just on productivity, because if the team is focused completely on that, one of the things that can happen is productivity gets inflated, which means the write-offs go up. The firm's practice-management system will report this.

It works like this: On the 5th of every month, every team member generates his or her key reports from the firm's practice-management system (if the person can't do it, then we can accept a nonbillable person creating reports for the team member) and sends an e-mail to his or her direct supervisor with an analysis of his or her productivity, WIP, average charge rate, write-offs, and A/R. These are then collated so that an overall view and analysis of firm performance can be obtained and compared to the firm's plan.

If the firm isn't ready for self-accountability, the process will take longer, and the firm can expect haphazard results. The members of the firm need to say to themselves, "We're professionals, and we need to hold ourselves accountable. It is not acceptable to receive a paycheck every week whether or not we are productive." The members of the firm need to sign on, essentially saying to each other, "Listen, you need to

track your own performance. That's part of the deal. You're accountable." Ultimately, it falls on the partners. (A lot of partners don't like accountability—that is why they are partners.) If some team members don't have enough work to do, something must be done about it. That could mean laying people off or changing the model. A lot of firms get caught in a trap in which they think they need someone all year, but they're really only productive around tax deadlines.

Team members should also be encouraged to project the next month, including what key nonbillable initiatives they are going to focus on (and what they expect in return). Nonbillable time in most firms produces nothing. Alternatively, I find that measuring nonbillable time can be as important and productive as billable time. I like to think billable time is today's income, and nonbillable time is tomorrow's income—as long as the nonbillable time is client/marketing-focused rather than admin-focused. The first step in improving the numbers is tracking them.

Pricing

A key driver in improving your numbers is pricing. We love discussing pricing because there is no right answer, and nothing can ignite a typically quiet room of accountants like discussing pricing. Here are several key strategies:

- *Price up front and drive time down.* We suggest to the firms we work with that they employ a no-financial-surprises principle in their performance standards. A few key notables:
- You must be an above-average pricer to price up front. If you are a poor pricer, pricing up front is not something to try at this point.
- You have to exercise change orders (and they must be in your engagement letters). We know too many firms that focus on getting the work out the door, particularly during busy times, and don't call the client to get approval to do the extra work. The result is increased write-offs and lower average rates. Could you imagine an auto mechanic having write-offs like CPA firms? Frankly, we love the way auto mechanics price up front and get approval for all work before doing it. Remember, a service in demand is worth a lot more than a service delivered.
- *Focus on minimizing open jobs and maximizing closed jobs.* You need to have a guideline—better yet, a rule—that you will not start a job until at least 70 percent of the information is in. You should also have a weekly goal of projects completed. Every firm should be reviewing WIP reports weekly.
- *Keep productivity up by ensuring there is sufficient volume in the system.* Workload compression will always be an issue in the United States. Yes, understaffed during busy season and overstaffed during the summer. Again, this goes back to tracking nonbillable time.
- *Engage clients with an up-front price, and do not start until the price is agreed and an internal hourly budget is in the system.* Another significant culprit we see driving write-offs is no budgets. As a very important aside, we all want to know whether we are doing a good job or not. How does your team know if they don't have a budget?
- *Price and bill based on a target average hourly rate, and keep raising the bar.* One of the first things you need to do is look at your average hourly charge rate by client. Why is it that you can be getting \$70 an hour on some jobs and \$300 an hour on others? We are not talking about the outliers either.

Case study

As you can see in the example three years that are presented in Exhibit 1, in the first year there was strong improvement. Implementing a program of self-accountability and focus on key profit drivers can make an immediate difference. As you can also see, between Year 2 and Year 3 the change was less dramatic. It is a little like the way a person going on a diet can have dramatic results at the beginning of the process.

Focus is important. Once people within the firm are focused on the key profit drivers and renounce bad habits (e.g., stop working for free), they will see a difference. Paying attention is important. For example,

with today's communications technology, a lot of productive time is nibbled away by little phone calls and answering e-mails that isn't captured in a timesheet environment.

The director of operations needs to print out that WIP report and review it. The firms that I see that had billing policies (e.g., they progress bill everything over \$2,000, all tax returns are built and completed, and so on) are able to hold people's feet to the fire and reduce WIP, reduce write-offs, and increase cash flow. It is similar to the way a company might review its aging of accounts receivable and adhere to credit policies. Holding people's feet to the fire means looking at what is in the hopper and what the holdup is, for example:

- Are we waiting on the client?
- Are we waiting on the team member?
- Is the work sitting in a partner's office?
- How are we getting work out the door and billed and collected?

Some firms have meetings, while other firms simply distribute the work report. Ultimately, either a partner or the director of operations has to own this process.

In addition to positive teamwork, a little peer pressure can help, such as seeing your numbers compared with those of your colleagues. Everyone has a revenue target, everyone has to produce. If one person is producing and six aren't, everyone should know about it. Partners, even considering their role, are not necessarily inherently driven to produce. They are human beings: Firms have go-getters, and they have underperforming partners too. The firm culture needs to embrace self-accountability.

Once the focus is established and benchmarks are routinely hit, it becomes more difficult (see Years 2 and 3 in Exhibit 1) to make gains that are as dramatic as at the beginning of the process. There is a lot to be gained in Year 1 just by being aware and looking at your work habits, including e-mail and phone habits.

Exhibit 1: Example Three-Year Results

Key Profit Driver	Year 1	Year 2	Year 3
Productivity	52%	63%	67%
Average Charge Rate	\$127	\$148	\$154
Write-Offs/Write-Ups	12% of WIP	7% of WIP	9% of WIP

Further improvements in productivity may require changes in the business model, but when a firm is responsive to its Six Key Profit Drivers, it is in a better position to consider such choices (e.g., doing more business work, meaning work that comes in all year round, or developing other lines of business, such as adding accounting and auditing of nonprofits or offering bookkeeping services, and other ways of staying productive all year).

In summary, here is what we believe you need to target:

- *Productivity*. You should be targeting the 75-percent range.
- *WIP*. This should be appropriate for the size of firm, the type of work it does, and time of year.
- *Average hourly charge rate*. This should be around \$150.
- *Write-ups/write-downs*. This should be five percent, assuming your average hourly charge rate is close to \$150 and a 75-percent productivity rate.
- *A/R*. Nothing over 90 days.
- *People leverage*. Seven billable people at 75-percent productivity per partner

Further, there are a few key questions you must ask yourself and your partners before you embark on improving your numbers:

- Do you want to improve the performance of your business?

- Are you willing to change?
- Are you willing to be accountable?

Many firms are surprised to learn that in spite of the possibility of uncomfortable conversations about accountability, team members are actually happier when accountability is established. It turns out team members want to know whether they are doing a good job or not and what is expected of them. It is not only about the money, a virtuous circle is established at a firm: Team members are happier when they know what is expected and whether they are hitting it or not. When they meet their goals, they feel like they have accomplished something. What's more, work gets out the door faster. Yes, profits and cash flow increases, but the best part is you will have happier clients too.