



SMALL FIRM SOLUTIONS

WINNING STRATEGIES FOR PROFITABLE FIRMS

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HOT TOPICS FOR SMALL FIRMS

FROM JAMES METZLER, AICPA VICE-PRESIDENT, SMALL FIRM INTERESTS

Welcome to the latest issue of Small Firm Solutions, the AICPA e-newsletter created especially to address the unique needs of members in the smallest firms. We hope that you find this publication useful and responsive to the challenges you face.

Here's an update on some of the recent developments that will have an impact on small practitioners:

The Institute's Reliability Initiative. Of all current AICPA initiatives, this is the one most likely to affect small firms in a positive way. Many of you have expressed serious concerns over AICPA Ethics Interpretation 101-3 and the confusion over it. Practitioners find themselves in a grey area, where they must choose between seemingly acting in the role of management in many typical engagements for small business clients and impairing their independence, the cornerstone of our profession. Many small businesspeople depend on their CPAs for a great variety of services, most of which improve the reliability of their financial reporting. These services that actually strengthen financial reporting and better protect the public interest could be construed as impairing independence when interpreted in the strictest sense under existing rules. What clients really seek are dependable financial information and advice. The bankers who work with small businesses, too, are usually more interested in the integrity and objectivity of the CPA firm that put them together and the accuracy of the financial statements they review, rather than in the independence (other than financial or ownership interests).

To solve the problem, many of you state in your compilation reports that you are not independent. Current rules do not allow you to state the reason for your lack of independence, so the user cannot tell if it's caused by a financial interest, an ownership interest or the performance of a non-attest service that may cross the independence line. Although this may be a solution, it's not the right solution for the client because most readers erroneously assume that the problem is due to a financial or ownership interest, which are the most serious kinds of impairment.

Aware of this problem, the Institute created a Reliability Task Force, made up of the Chairs of PCPS Executive Committee and of the Accounting and Review Services

Committee, as well as members of ARSC, the Auditing Standards Board and the Professional Ethics Executive Committee, plus representatives of the banking, preparer and academic communities. Their goal was to study and make recommendations on the reliability of financial statements for private companies. In a report released to AICPA Council in May, they recommended examining ways to provide a review or compilation report that addresses reliability rather than independence (other than a financial and ownership interest). The report proposes that integrity, objectivity and reliability go hand in hand with independence. It will go through a thorough vetting process with all facets of the profession and ultimately will no doubt have modifications. The ultimate aim is to allow CPAs to continue to provide a high level of respected quality services while offering small business clients and financial statement users the information and advice they truly need.

What small practitioners need to know. You should keep this on your radar screen because it is an initiative whose time has come. When it does come to fruition, it could reduce many of the barriers and complexities that prevent CPAs from continuing to build and maintain strong relationships with clients. Watch for further updates on the PCPS Firm Practice Center at www.aicpa.org/pcps and in this newsletter. Please do write comment letters when the opportunity arises or even when you feel compelled to do so. Your support and opinions are critical to this initiative becoming reality. You can write me anytime at jmetzler@aicpa.org.

International Financial Reporting Standards. As the United States heads toward convergence with international standards, I can't overstate the many potential opportunities in this area for small practitioners. This is no longer simply a big-firm issue, since even the smallest companies are increasingly doing business in the global marketplace. According to the U.S. Small



Business Administration, exports by U.S. small businesses soared fourfold—to \$400 billion—between 1992 and 2007. And it's expected that half of U.S. small businesses will be involved in international trade by 2018.

To introduce the subject to clients, remember that small businesspeople will be much more open to a discussion about seizing international business opportunities than about preparing financial statements. Some of your clients may already have been approached by overseas companies interested in doing business with them. Many know what products and services they could sell or buy overseas, but they may not be sure how to do it. For example, international transactions involve credit approvals from sources outside the United States, as well as granting credit to potential customers. This is not limited to supplier/customer credit but applies more significantly to bank credit, bonding agents, brokers, insurance companies and other financial institutions. A CPA knowledgeable about international business can provide invaluable help in navigating financing and other business questions and enabling clients to seize or increase their global business options.

The best way to introduce the topic is to ask the client for lunch or coffee to talk about emerging trends. Begin the conversation with some probing questions.

- What sales opportunities do you see for your products/service outside the United States?
- What supplier and outsourcing opportunities are there for your business outside the U.S.?
- What are the merger opportunities?
- If you had a capital source outside the U.S. to expand, what do you think you could accomplish?

What small firms need to know. This is a great time to begin talking to your clients about seizing international business opportunities, because that's what convergence will undoubtedly open up for even the smallest business. Small firms that establish themselves as experts early on in the process will be in a great position to leverage their knowledge into some excellent practice expansion opportunities. Your clients are likely already hearing about international opportunities in their trade associations, trade press and local business group meetings. They know what they can sell overseas and to whom, but they don't know how. They will value your knowledge about international business, since you can help them navigate the financial aspects—including evolving reporting standards requirements—so that they are positioned to launch or increase their overseas efforts.

For more information on IFRS. The AICPA has launched a new Web site, www.ifrs.com, to educate our members and other interested users about international financial reporting standards. We'll also update you on new developments in future issues.

The Certified in Financial Forensics credential (CFF). I'm very excited about a new credential in forensic services that has been approved by the AICPA Council. CPAs with expertise in this discipline will be able to earn this designation to demonstrate their knowledge of the field. Businesses are increasingly turning to experts to help them with a wide variety of issues such as economic damages, family law, fraud investigations and litigation. The Certified in Financial Forensics credential combines specialized forensic accounting knowledge and expertise with the skills that make CPAs among the most trusted business advisers. Forensic accounting has become a popular career choice, and the CFF will distinguish credential holders as forensic experts. And the CFF will encompass a broader range of disciplines than the popular Certified Fraud Examiner credential. It is expected to launch early this fall.

Why it's important for small firms. In the burgeoning field of forensic services, many small practitioners have already established thriving niches and distinguished themselves. This practice area offers many specialization opportunities for small firms, and a credential provides added credibility to those who earn it. A niche in this popular specialization can also be a valuable retention and recruiting tool. Institute research has shown that the market will welcome this new credential.

Where to find more information. Practitioners can e-mail cff@aicpa.org for more information. Also watch the AICPA Forensic and Valuation Services Web site for further details as plans are finalized (www.aicpa.org/fvs).

The FASB GAAP Codification. The *FASB Accounting Standards Codification* is currently in a one-year verification period. This new online resource organizes all U.S. generally accepted accounting principles pronouncements into one user-friendly reference. It will become the sole source of authoritative GAAP when adopted, which is expected to occur next year.

What it means to small firms. The Codification was intended to make it easier to find and use existing accounting literature. It reorganizes the thousands of U.S. generally accepted accounting principles pronouncements into roughly 90 accounting topics, and uses a consistent structure to display all of them. It includes standards from the FASB, the AICPA's



Accounting Standards Executive Committee and the Emerging Issues Task Force, and related literature. This should be a huge time saver for small practitioners grappling with standards overload. Small firm members are continually pressed for time. This definitely is a solution for you when it comes to accounting research. And you have the opportunity to offer feedback, based on your own examination of the

Codification during the verification period. To register free to review the Codification and take it for a test drive, go to <http://asc.fasb.org>. ■

TECHNOLOGY

AFTER QUICKBOOKS, WHAT'S NEXT?

Many small business clients continue to use the basic accounting package that their CPAs first recommended to them years ago. But is that software still doing the job? Those programs—including QuickBooks from Intuit as well as comparable offerings from Microsoft and Sage—are excellent options in the right circumstances, but they may not suit the needs of a growing client. What are the CPA's choices when a client has outgrown the basic software?

Spotting Trouble

“The problems usually begin when the client’s requirements go beyond basic accounting,” notes CPA David Gieslak, a principal in Arxis Technology, Inc., and the chair of the AICPA Information Technology Executive Committee. Basic accounting software is acceptable for standard general ledger and receivable uses, but “if the client has a warehouse or wants to use the software for human resources, customer relationship management, and especially for electronic data interchange, those modules are above and beyond what basic software will do. The more advanced applications also offer the greatest opportunities for the organization to improve efficiency and effectiveness.”

“There are two immediate clues that there is a problem,” says Greg LaFollette, CPA.CITP, executive editor of *The CPA Technology Advisor* and chair of the AICPA CITP Credential Committee. One sign is when the accounting staff reports that they are devoting a lot of time to repairing tasks incorrectly done. “This could simply be the result of errors, but when users are trying to torture QuickBooks into doing something it won’t,” that’s a sign of growing pains. For example, handling inventory in two locations is a difficult challenge for the software, he says, as are commissions payable, among other tasks. “If the staff is spending time trying to figure out how to outsmart the software, then there’s a problem. The company has started to get more sophisticated and the software can’t keep up.”

The other clue, according to LaFollette, is when management members can no longer access the necessary information for decision making. That’s a sure sign that they are working with a system that was never

designed to track and report the more complicated details needed in a growing business.

Consider Add-ons

In some situations, add-on software can be a great solution, according to LaFollette. These programs combine with the basic accounting software and are designed especially for one purpose. For example, companies with inventory needs can turn to a company like Fishbowl, which has software created to work with QuickBooks (http://www.fishbowlinventory.com/getting_started/software_overview/?utm_source=google&utm_medium=cpc&gclid=CPDq7KicoZMCFQNFQodDzL03g). In another area, many companies offer add-on time and billing software (he mentions BillQuick as one example: www.bqe.com). In some cases, the applications can be extremely narrow. LaFollette cites one program that offers everything necessary to run a nail salon, including applications for advertising, scheduling, commissions to manicurists, recalls and special offers.

Because of the wide variety of options, “the question is not what software to use, but what the company wants to do,” LaFollette says. “There are many of these highly specialized verticals. I would guess that in 80% to 90% of the cases they will solve the problem for a long time.” It may not be necessary to discard the accounting software; instead, a well-chosen add-on may do the trick. And finding the right program for the client, according to LaFollette, may require nothing more than a quick Google search.

Taking the Next Step

In other instances, however, it may be time to move on. Basic accounting software can serve an important purpose, “but at some point it becomes detrimental to the



client to continue with it," Cieslak says. "There is a value to the customer in having a more comprehensive product. You don't want to tailor the business to fit the product. Once the company has grown to a certain size—they have more than two to four users or they want to incorporate other functions—it's valuable to have it all integrated." Basic software automates the role of the bookkeeper, but a more comprehensive package makes it possible to automate other functions.

As a possible first step, LaFollette notes that there are more advanced programs for each of the three major basic accounting choices, including QuickBooks Enterprise Solutions (http://quickbooksenterprise.intuit.com/?priorityCode=1183006329&CMP=KNC-Core_Brand&HBX_PK=QuickBooks+enterprise+solutions&HBX_OU=50&SiteID=6345102), Microsoft Dynamics (<http://www.microsoft.com/dynamics/default.aspx>) and Sage MAS 90, 200 and 500 (http://www.sagemas.com/products/sagemas90_mas200/). Vendor Web sites feature information centers, including online community sites, where users can share ideas (the QuickBooks Client Solution Center can be found at <http://proadvisor.intuit.com/product/client-center/index.jhtml>).

Where can a CPA find information when a more complicated solution is called for? Cieslak recommends

beginning at vendors' Web sites to learn about programs and test drive demos. In addition, the vendors can offer information on technology consultants or resellers in your area.

"It's best for the CPA to educate him- or herself or work with a reseller with whom they are comfortable," he says. "That person should work with the client and keep the CPA in the loop."

LaFollette agrees. "Every accountant should have a relationship with a midlevel value-added reseller," he says. He also recommends that CPAs with technology questions go to www.aicpa.org/infotech and find a CITP, someone who is a CPA with demonstrated technology credentials. "They are knowledgeable about bits and bytes as well as debits and credits," he says. "They are the bridge between the two."

In any relationship with a technology consultant, the CPA should be in a position to quarterback the engagement, working with both sides to see that client needs are met. "You want to know that the client isn't simply working with a software salesperson," LaFollette advises. "Make sure the person has the appropriate financial background." ■

PRODUCTIVITY BOOSTERS

ONLINE BACKUP FOR HOME/SMALL OFFICES

By Roman Kepczyk, CPA.CITP

Computers have become an integral part of most people's lives and business. Many people store all their working documents—as well as their personal photos, videos and accounting—in digital files on their workstations. How well would that information be protected if the computer were stolen, the hard drive crashed or if the entire office were destroyed in a fire or other disaster?

Many people use external USB hard drives, CDs or tapes for backup, but these backup media are only secured if they are protected in a remote site. As high-speed Internet connections have become available for virtually everyone, options to back up data to an offsite location via the Internet are becoming cost effective. Vendors such as Dell's DataSafe, HP's Upline, or even AOL's XDrive provide solutions that are ideal for a small or home office and individual practitioners to back up their data. The costs of these services vary from being free for the first 5 Gb in XDrive to unlimited access for three business users for \$299 a year with Upline. In addition, dedicated products such as SOSOnlineBackup and Mozy Business get high marks from users for providing more robust file management, with some of the products automatically backing up any changed files.

When evaluating online backup tools, particularly for business files, it is important to verify that the data is encrypted before being transmitted, that it is compressed to effectively use the bandwidth available, and that it has an easy user interface for both individual or multiple personnel within a small office to access the data. While most people should continue to do local backups of some kind, having an online backup provides added peace of mind that the data is truly protected.

Roman H. Kepczyk, CPA.CITP, is President of InfoTech Partners North America, Inc. and works exclusively with accounting firms to implement today's digital best practices. His e-mail address is roman@itpna.com. ■



PRACTICE DEVELOPMENT

MINING FOR GOLD IN YOUR OWN BACKYARD

By James Metzler, AICPA Vice-President, Small Firm Interests

The months after busy season are an excellent time to turn your attention to practice development efforts. But is your firm positioned to make the most of its opportunities? In many cases, practitioners may find themselves tripping up on their own internal barriers to cross selling success. Here are some of the biggest hurdles you may have to overcome.

Chasing the new. Expanding your practice is not only about adding new names to your client list. In fact, that's the toughest target. Instead, take a better look at your existing clients to identify new areas in which you can help them. Dig out those notes you made during the busy season on ways that you could help a valued client when you did not have time to speak to them further.

Individual ownership of clients. It's not possible for one person in your firm to provide every service to all of his or her clients. If your firm allows partners to develop a sense of ownership of their client list, you will almost certainly miss out on opportunities. Instead, it's best to develop a firm culture that favors partner alignment and compensation methods that reinforce cross selling strategies. And remember that this is not simply a problem in larger firms. Even a two-owner operation can build separate silos in which each partner focuses on his or her own clients and fails to maximize cross selling opportunities.

Compensation systems don't reward cross selling. It is possible to determine how much business is brought in through cooperative cross selling techniques and to decide how to compensate those who contribute to successful efforts. This will motivate partners to change proprietary attitudes toward clients and participate in sales efforts that benefit the entire firm.

No cross selling process. When a partner realizes that a client may need services that another partner can offer, how should the referral process work? Who handles ongoing client contact? These are often tricky questions, and reluctance to address them may prevent partners from taking part in cross selling. The best idea is to anticipate the problems and create a set of procedures that facilitate cross selling. They don't have to be complicated, but they do have to be followed.

The annuity nature of the business. There are many compliance services that clients will need regularly,

year after year. As a result, practitioners sometimes forget to consider and market new services. This is a good time of year to try to break out of that rut. What do your clients need beyond the basic tax and accounting? How can your firm fulfill those needs?

What's our value? Every firm has its own practice value proposition, the elements that set it apart from others and inspire client satisfaction and loyalty. It's difficult to capitalize on that proposition, however, if all firm members are not aware of it and able to explain it to clients. You can address this problem in a firm meeting in which partners review the practice's benefits or in written communications that describe things you'd like your clients to know about your firm.

Getting Started

Once you cleared some of the most common barriers to cross selling, what are the first steps you need to take?

- Create a few simple tools (such as checklists and questionnaires) to convert cross selling into a core process of your practice. They will allow you to systematize the method of capturing opportunities, build in accountability for adherence and follow up on closing new engagements. In the sales world this is known as the "pipeline." Pipeline management means being sure new opportunities are regularly identified and added, and then put through a sales or communication process that makes it possible to convert them into new engagements and new clients.
- Walk before you run. Start this year with just with your top ten clients. I guarantee you that the amount of opportunity you uncover will amaze you. If you are in a larger firm, give each partner and manager this top-ten challenge.
- Streamline your process, start small and involve others. It doesn't take a natural rainmaker to identify client needs. Simply begin by asking them questions and bring everyone you can into the process. ■



THE NEXT GENERATION

VALUING THE SMALLER ACCOUNTING FIRM

By Joel Sinkin

For many smaller practitioners, their firm is one of their largest assets. They have worked for years to develop and nurture this practice and want to receive a reward for their sweat equity and loyalty. How do you value this asset?

Location, of course, is a factor. If you are in a geographic area where there are very few accounting firms, the supply-demand curve works against you. Obviously, if there are not many potential successors to your firm, the market will be soft. Therefore, this article will focus mainly on the important variables in areas where there is a reasonable supply of potential buyers.

Geography aside, there's good news for smaller firms in terms of overall demand. Although the medium and large firms have fallen significantly in value, small firms have experienced a smaller decline. The drop itself generally reflects the staffing shortage and the aging of the baby boomers, which has brought a larger number of sellers into the marketplace.

Most accounting firms are sold on a multiple of gross billings. The real question is: What are the variables that affect that multiple?

Down payment amount. The upfront payment can range from zero to 100% of the anticipated purchase price, but at the effective date of the deal the overwhelming majority of deals have a down payment in the range of 10% to 25%. Many aspects can and will affect this number beyond the depth of the buyer's pockets. Two large factors are the time of year of the closing and the treatment of the accounts receivable. A practice that generates the lion's share of its revenues during tax season may get a larger down payment in December than a buyer may be willing to provide in June. If a seller has an unusual amount of accounts receivable and wants to collect them before the buyer takes over, this too can affect the down payment percentage. Thus, the seller can use timing to influence the down payment.

The profitability of the deal for the buyer. The seller's personal net from the firm is not necessarily a good basis to calculate the value of a practice. Here's why: Let's assume the seller operates from his home, handles all the work himself and has a net of 85%. At some time in the future, the practitioner elects to take on an external office and hire some support staff. In which case is the practice worth more money?

The value of the firm depends on the value the buyer receives. If a buyer can integrate your practice into its

current infrastructure with no incremental increases in overhead, clearly that is more profitable than taking on a satellite office and staff they do not need. This will affect the amount the buyer can afford to pay and still realize a profit. So, the key consideration for most buyers is what *their* net will be. This includes the tax ramifications. A seller will not receive the same value for the firm if the deal is structured as a 100% capital gain (unless the payout is also 15 years) as would be the case if all or a percentage was structured to provide the successor firm a current deduction.

Length of guarantee or retention period. The overwhelming majority of practices sold include a guarantee or retention period that adjusts the balance due to the seller based on actual client retention and collection of fees post closing. These periods can be as short as one tax season or they can run the entire duration of the payout period. In rare circumstances, there are no retention periods.

Length of the payout period. The longer the payout, traditionally the lower the monthly payment, the greater the cash flow. Most payout periods are between 3 and 10 years, with the highest percentage between 4 and 6 years—but there are exceptions to all these rules.

Multiple. Most practitioners want to know what the multiple should be. The multiple is the product of the rest of the variables. In the simplest of terms, the longer the payout and retention periods, and the more profitable the deal is for the buyer, the less cash upfront, the higher the multiple. Obviously the opposite is true, as well.

There are of course other factors that play into the value. These include but are not limited to cross selling opportunities and hard assets that may be included in the sale, as well as staff that come along with the deal. Given the horrific staffing situation many firms are experiencing, good quality staff can actually make a practice more attractive to many firms today.

Although a remote location can work against you, location can be an asset when a potential buyer wants to expand into another marketplace. Your client base is another factor. A practice that has many young, healthy, growing clients and businesses is likely to receive a



higher offer from a buyer than a practice with all aging clients who themselves are closing in on succession.

Remember that a good deal is a fair deal. Finding the happy compromise where the seller receives an appropriate reward for their years of work and the buyer makes a profit is the key to establishing a win/win deal.

Maximizing the value in your firm strongly depends on choosing the “right” successor. The buyer who retains your clients is, in most cases, the one who will be the most profitable for the seller. Once the right buyer is found, creating a transition plan that retains

clients—and in cases where it is appropriate for the staff—is equally as critical. We’ll address that topic in an upcoming issue.

Joel Sinkin (jsinkin@transitionadvisors.com) is a partner in Accounting Transition Advisors, LLC, which exclusively consults on the merger & acquisition of accounting practices nationally. He teaches CPE for state and national accounting associations and has consulted on over 900 accounting firm closings and succession plans and published books and articles nationally. He can be reached at 866-279-8550 or at www.transitionadvisors.com. ■

AWARDS FOR *SMALL FIRM SOLUTIONS*

The AICPA's *Small Firm Solutions* has recently won two prestigious awards. The newsletter won a Gold Award in the prestigious Hermes Creative Awards and an Award of Distinction in the esteemed Communicator Awards. Both are international competitions that recognize excellence in communications. The first two issues of *Small Firm Solutions* have received over 100,000 downloads from the PCPS Firm Practice Center (www.aicpa.org/pcps).

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SMALL FIRM SOLUTIONS is a quarterly e-newsletter designed to help AICPA members in the smallest firms make the most of their opportunities and keep track of important developments in the profession. It offers news updates as well as articles with practical solutions to common practice challenges. ■

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