Adding Up All The Costs: How Accounting Services Are Priced

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STARTING UP:
Practical Advice for Entrepreneurs

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I have many technology entrepreneur clients who can recite to the penny the cost of the latest Pentium PC or Sun Sparc workstation with a given configuration of memory, processor, disk drive etc. However, there are many other areas where they have absolutely no clue as to the costs of items which are central to their business. In many cases they don't even have a concept of what drives these costs. This first in a series of columns will provide facts and tips which may not be generally known about these costs. Because the data are drawn from the experience of my clients and me, they are necessarily limited, so I invite comments from readers who would like to share their data and experience.

<u>What Do Certified Public Accountants Do and Why Do You Need Them?</u> Although CPAs provide a range of valuable management consulting services, the typical entrepreneur is looking to an accounting firm to provide three basic services: tax returns, bookkeeping and audits/reviews. Tax returns are required by law. You can do them yourself but you are better off in most cases letting the experts handle this while you focus on your business. Although bookkeeping is required to support tax returns, a properly designed bookkeeping system is also needed to manage your business effectively. Even if you are not ready to ship product you should implement a good bookkeeping system as soon as possible. Audited financial statements will be required by most investors and banks, can be of help in dealing with large customers and are required if you go public. Note: because the auditing firm must be "independent", it cannot do your bookkeeping but it should be able to recommend a good bookkeeper. The "reviewed financial statement" is a less costly alternative but is less extensive and usually does not involve verification of data. Banks and investors may not accept reviewed financial statements, so make sure you check with them first.

<u>How Do They Charge?</u> Like other professional service businesses, accountants are basically selling expertise by the hour. Simple economics requires the accounting firm to charge out its labor at a rate which covers overhead (rent plus staff salaries), the salary of the employee accountants plus a profit. A typical hourly rate constitutes a mark up of about 100% over the allocated overhead cost plus the salary paid to the accountant-employees.

Where billing is on the traditional hourly rate method, there are at least two important factors to consider. First, does the person who is doing the work have the appropriate level of experience- e.g., you don't need to have a senior partner do a task which could be done by someone with lesser experience at a lower billing rate. On the other hand, you also don't want a junior person spending lots of hours trying to figure something out that a senior person may already know. The second major factor is whether the work is being done efficiently. This does not necessarily mean in the fewest hours. For example a senior person might be able to do a task in one hour while a junior person might take two times as long, however, the lower billing rate of the junior person might make that person the most efficient person to do that task. You can help by making sure that the expertise which you are renting by the hour is being used appropriately and not to gather together information which your people can assemble.

Fixed Charge or Discount Billing. Sometimes accountants will do fixed cost instead of hourly billing. This happens where the tasks are repetitive enough that the accountant can on average make a profit. Fixed charge billing might also be done as a "loss leader" in a new client relationship. However, fixed charge billing is harder to do on open-ended tasks. In recent years I have seen a variety of innovative approaches which try to provide services within a budget and provide incentives on both sides to make it work. Most often this works in the context of a long-term relationship.

Firms may also do discount billing, especially for promising start up companies or for larger companies which generate lots of work. Accounting work can be highly seasonal with tax and public company reporting deadlines. Avoiding having your work done at these "crunch" times can save money.

Timing of Payments. Some firms may be flexible in the timing of payments of bills, especially for promising entrepreneurial companies where a longer term relationship is anticipated. Flexibility in timing and rates may actually be easier to achieve with larger firms which have a larger client base over which to spread the costs. Although smaller firms usually have lower overhead and lower rates they may have a more pressing need to be paid on a current basis. Finally, firms cannot issue audit statements unless they are paid currently so you need to factor this into your cash flow projections.

Equity In Lieu of Cash Fees. In order to remain "independent" auditing firms may not accept stock in lieu of cash for payment of fees.

Ranges of Costs. Based on a limited sample, I found the following cost ranges in the Boston market in December of 1995:

	Big National Firm	Smaller Regional Firm
Hourly Rates	$65 to $420	$50 to $225
Reviewed Statements	$3,000 to $20,000	$7,000 to $10,000
First Year Audit for New Early Stage Client	$5,000 to $25,000	$10,000 to $20,000
Corporate Tax Return	$2,000 to $10,000	$1,200 to $1,500

The actual rates and costs will vary based on the complexity of the business, the transactions which have occurred in the year, the quality of the company's records etc.

Recognize Value. Don't be an entrepreneur who knows the price of everything but the value of nothing and don't assume that the lowest cost solution is the best one. In choosing an accountant you should be looking to establish a close working relationship with a person who can add value to your business as part of an external management team. That “value” can be the person’s unique experience, business “smarts”, industry knowledge or contacts in the financial world. Also look to who else at the firm will be a part of your “team”.

DISCLAIMER: This column is designed to give the reader an overview of a topic and is not intended to constitute legal advice as to any particular fact situation. In addition, laws and their interpretations change over time and the contents of this column may not reflect these changes. The reader is advised to consult competent legal counsel as to his or her particular situation.