

# "Adding Up All The Costs: How Accounting Services Are Priced"

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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 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 column 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 myself, they are necessarily limited.

## **What Do Certified Public Accountants Do and Why Do You Need Them?**

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 can not 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.

## **How Do They Charge?**

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 percent over the allocated overhead cost plus the salary paid to the accountants.

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? In other words, 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. Second, is the work 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 for free.

### **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 can not 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.

### **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.*