public practice in australia

RESULTS FOR MEMBERS

CPA AUSTRALIA BENCHMARK SURVEY - 2004

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Public Practice in Australia CPA Benchmark Survey 2004 – results for members

Report on public practice benchmark survey

As Chairman of the Board Public Practice Committee (BPPC) of CPA Australia, I am delighted to present the findings of our latest public practice benchmarking survey. With approximately ten thousand public practice units in Australia today, and 93% of the market comprised of sole practitioner and two partner firms, the fragmented nature of the market results in limited data being available on the performance of the market and emerging trends.

CPA Australia, through the BPPC, commissioned a survey of its members to assist in understanding market performance and trends. This report represents a compilation and analysis of data provided by members who have elected to participate in the survey.

Survey participants were asked a series of questions based on their operating performance for the 2003 financial year. They were further asked to comment on their current directions and plans for the future.

CPA Australia commissioned one of Australia's leading practice management consultants to analyse and comment on the data. This commentary provided at both a macro and individual level was designed to assist members in identifying underlying reasons behind practice performance. Further it provided commentary on how practice performance could be enhanced under different scenarios.

The survey design, data compilation, analysis and commentary were undertaken by Knowledge Shop and one of its directors Mr Greg Hayes. Greg is a partner in accounting firm Hayes Knight with over 25 years experience in public practice. He is a well known in the areas of practice management and has been an active commentator in this area for over 15 years.

Greg is a Fellow of CPA Australia and a current member of CPA Australia's Taxation Centre of Excellence. He has been a member and chairman of the NSW Public Practice Committee, a member of the National Public Practice Committee and a past chairman of the Small Business Centre of Excellence. He is a joint author of the current CPA Public Practice program in addition to being an author and contributor to a number of tax and small business publications.

On behalf of the BPPC, I wish to acknowledge the support of CPA Australia's public practice members who participated and freely gave their time to complete the survey. This survey is one of the largest of its type undertaken in the public practice market and provides a most comprehensive analysis of current practice management issues and emerging trends. It is hoped that the survey results will help members expand their business and develop goals that reflect opportunities supported by the industry, market and CPA Australia.

John Mann
Chairman, Board Public Practice Committee

Report highlights

This survey provides the most current information on what is happening in public practice in Australia today and where the trends are emerging. It paints a picture of a broad range of public practice models ranging from sole practitioners working from home to larger multi disciplinary partnerships. The client bases of these firms range from a few to thousands. In some cases they employ no staff, in other cases they are mid size employers. This range and differences are what represent public practice in Australia today.

Some of the report highlights include:

- Traditional compliance services in taxation and accounting have been strong growth areas and there is a continuing trend of growing demand for these services.

- Financial services are the fastest growth area for CPA firms. Members are increasingly providing financial planning and finance services to their clients.

- CPA firms are breaking the traditional mold on how professional services firms manage their debtors and work in progress. The efficiency levels achieved by the majority of firms are at best practice levels.

- Staff to partner ratios, and charge rates limit the profitability of the average CPA firm. The top quartile firms achieve strong results but many firms limit their profitability through insufficient staff leverage and low charge rates.

- Fees managed per principal or partner is on the low side. This also reflects the limited staff leverage with many partners undertaking a lot of hands on work. Typically the number of clients managed per principal or partner is high but it may not always be profitable work.

- Employment with a CPA firm is not only growing, it is an attractive option. The average firm is looking for a balance for their employees between chargeable time and professional and personal development.

- Succession is the biggest strategic issue facing the profession. The first group of the baby boomer generation of public practitioners is in their retirement decade.

- CPA firms continue to grow in size and increasingly are providing a broader range of services to their market.

- CPA firms are contributing to the employment growth of the country.

Changes since the 2000 national practice management survey

CPA undertook a survey of public practitioners in 2000. Over the last four years what changes have occurred and trends emerged?

- In 2000, 78% of respondents were sole practitioners. By 2004 this had dropped to 73%. This may reflect a trend toward larger practice units and an increasing number of practice mergers.

- The average age of principals in 2000 was 46. Whilst the 2004 survey didn't ask for the actual age of principals it did find that 40% were more than 50 years of age and 69% more than 40 years of age. This seems to confirm anecdotal evidence that the profession is ageing.

- In 2000, 53.3% of fees came from compliance work. By 2004 this had increased to 72%, reflecting an increase in compliance work likely driven out of tax reform and the introduction of the Goods & Services Tax.

- The succession issue emerges as one of the major change areas. In 2000, 7% of partners indicated an intention to retire in the next 2 years. By 2004, 25% of firms indicated that they had at least one partner who planned to retire in the next five years.

- Financial planning as a service area continues to grow. In 2000, 43% of respondents indicated that they provided financial planning services to their clients. By 2004, the number had increased to 54% of firms responding to the survey.

Section 1

What the survey said

The response to the survey paints a picture of public practice in Australia today. Responses were received from sole practitioners through to multi-partner firms; city, suburban and regional practices, with a distribution across all states in Australia. The survey obtained a range of demographic, operational and direction information. By analysing the survey responses we are able to draw reliable conclusions on areas of:

- profitability;
- liquidity;
- efficiency; and
- growth.

These four key drivers, together with general demographic information on the profession allows us to focus on the business performance of public practitioners and how change may be able to influence that business performance. Reference in this report to performance by top quartile firms refers to those firms who measure in the top quartile by profitability, of all respondents.

Let's have a look at what the survey tells us.

What is the size of the public practice firm?

Public practice in Australia is dominated by small practice units. On a national basis 73% of all respondents were sole practitioners. The remaining 27% were multi partner firms, with only 5% of firms being 4+ partner firms. The majority of firms (88%) operate from a single location.

What is the age profile of public practitioners?

Responses were reasonably evenly distributed across all age profiles. The similarity across a number of age bands was quite marked. The distribution was represented by the following age bands:

<40	31%
40-50	29%
50-60	32%
60 plus	8%

Anecdotal information suggests a higher percentage of practitioners across the profession in the 50+ age range. A later question in the survey identified that in one in four firms either the principal or one of the partners intends to retire in the next 5 years. This suggests that we are going to see a significant change in the public practice landscape over the next few years. Succession issues will be high on the radar of many firms.

Staffing

What does the staffing mix look like in a CPA firm? Participants were asked to quantify the number of FTEs (Full Time Equivalents) employed in their firm. Employment categories were separated between qualified accounting staff, graduates, non qualified accounting staff, degree qualified non accounting staff and support staff.

15% of respondents to the survey did not employ any staff (or did not include staffing details). For those firms reporting on their staff the key national statistics are as follows:

- the average sole practitioner employs 3.65 FTEs, with the top quartile employing 5 FTEs;
- the highest staffing to principal ratio reported was 17:1;
- the average partnership employs 3.2 FTEs per partner, with the top quartile employing 4.42 FTEs;
- the highest staffing to partner ratio reported was 8.5:1.

Statistics across the country were as follows:

	ACT-CBD	**ACT-CBD**
	Sole Practitioners	*Partnerships*
Average	4.8	3.8
Maximum	13.5	7.2
Top quartile	4.8	5.5

	NSW		**NSW-CBD**		**NSW Regional**	
	Sole Practitioners	*Partnerships*	*Sole Pract*	*Partnership*	*Sole Pract*	*Partnership*
Average	3.3	2.4	3.4	1.9	3.0	3.0
Maximum	8.0	5.4	8.0	3.0	5.0	5.4
Top quartile	4.0	2.8	4.3	2.4	3.5	4.4

	QLD/NT		**QLD/NT – CBD**		**QLD/NT Regional**	
	Sole Practitioners	*Partnerships*	*Sole Pract*	*Partnership*	*Sole Pract*	*Partnership*
Average	4.2	3.3	4.2	4.1	4.2	3.0
Maximum	11.0	5.0	10.0	4.7	11.0	5.0
Top quartile	5.8	4.5	5.0	4.3	6.0	4.2

	VIC/TAS		**VIC/TAS-CBD**		**VIC/TAS-Regional**	
	Sole Practitioners	*Partnerships*	*Sole Pract*	*Partnership*	*Sole Pract*	*Partnership*
Average	3.1	3.8	3.2	3.6	2.8	4.1
Maximum	17.0	8.5	17.0	6.5	8.0	8.5
Top quartile	4.0	4.8	4.0	4.7	4.4	4.8

	WA/SA		**WA/SA-CBD**		**WA/SA- Regional**	
	Sole Practitioners	*Partnerships*	*Sole Pract*	*Partnership*	*Sole Pract*	*Partnership*
Average	3.8	2.7	3.2	2.7	5.6	2.6
Maximum	14.0	5.0	9.0	4.5	14.0	5.0
Top quartile	5.0	3.5	4.8	3.6	5.8	3.5

On average, a CPA firm employs between 1 and 1.5 of each qualified accounting staff, graduates, non-qualified accounting staff and support staff.

Are CPA firms growing and what are the typical staff turnover rates? The key numbers coming out of the survey were as follows:

- new staff recruited during the last year represented 25% of total staff;
- during the same period the typical firm lost 16% of existing staff;
- in the average CPA firm staffing had a net increase of 9%.

Service areas

The survey indicated that firms work in a broad range of areas but revenue flows from a relatively narrow range of those services. The polarisation of revenue is quite strong.

Service Area	% of firms delivering this service	% of revenue from this service area
Tax compliance	95	50
Accounting compliance	80	22
Management accounting	43	5
Forensic accounting	51	5
Audit	52	4
Financial planning	25	4
Business advisory	41	4
Finance advice/broking	52	3
Valuations	6	1
Superannuation compliance	18	1
Book keeping	7	1
Other	5	1
Insolvency	1	0
Expert witness	2	0
IT consulting	2	0
Specialist tax advice	8	0

Accounting and compliance services represent the primary revenue base of firms. The breadth of services identified indicates that firms are looking to broaden their service offering but there is no other service area that reflects a general acceptance by the profession and one where they have been able to successfully integrate it into their service offering. Clearly there are individual firms that have achieved this development successfully. Across the profession however there is no clear trend.

On average 81% of revenue comes from core compliance services (tax compliance, accounting compliance, audit and management accounting). Beyond this firms earn their revenue from participation in a broad range of service offerings but where they earn relatively small amounts from the different areas.

Relevant observations include:

Audit

Participation by 52% of firms but only generating 4% of revenues. This response may be skewed by firms undertaking audits of self managed superannuation funds and small non profit entities.

Financial planning
25% of firms deliver FP services but it only generates 4% of revenue. This suggests that many accounting firms have not achieved a sustainable business model in financial planning. It is interesting to note that in a later part of the survey 54% of firms indicated that they provided their clients with a financial planning solution. This suggests that a significant number of firms contract out the 'solution' for their clients.

Business advisory & Forensic accounting
Both are areas where a significant number of firms (41% and 51%) identify their involvement. Both these areas tend to utilise the core strengths of most accountants and represent natural areas for business development.

Finance broking/advice
At 52% participation rate this appears to be an area where accountants increasingly are being involved. This likely represents a growth area for many firms and reflects the position of 'trusted advisor' where the client is comfortable to engage their accountant to assist in this work.

When you look at services provided by firms that rank in the top quartile by profitability (as measured by gross fees per FTE) it is evident that there is a lower level of polarisation.

Revenue from service areas – top quartile firms

Service Area	% of firms delivering this service	% of revenue from this service area
Tax compliance	94	44
Accounting compilation	80	21
Forensic accounting	62	7
Finance advice/broking	61	5
Audit	48	2
Management accounting	45	7
Business advisory	41	3
Financial planning	30	6
Superannuation compliance	27	2
Book keeping	14	0
Valuations	8	1
Tax advice	8	0
Other	5	2
Insolvency	3	1
Expert witness	2	0
IT consulting	0	0

The top quartile profitability firms tend to provide a broader range of services and look to drive a greater proportion of their revenue from services where they are likely to achieve premium fees.

Where business growth is coming from

Survey participants were invited to identify where they had experienced the highest fee growth in the last year and where they expect to achieve the highest fee growth in the current year.

Highest fee growth areas last year:

Service Area	All firms %	Top quartile %
Tax compliance	42	36
Accounting compilation	10	8
Business advisory	8	11
Financial planning	6	6
Superannuation compliance	6	9
Audit	5	2
Management accounting	5	9

Highest fee growth area expected this year:

Service Area	All firms %	Top quartile %
Tax compliance	38	36
Financial planning	11	14
Accounting compilation	10	8
Business advisory	10	11
Superannuation compliance	6	9
Management accounting	6	11

New services introduced this year:

	%
Financial planning	9
Finance advice/ Broking	6

The results indicate that core accounting services provided the highest growth areas for the majority of firms. They also represent the area where the greatest growth is anticipated. An interesting question is whether this is driven from the comfort level of the accountant, focusing in the area where they have their greatest expertise and comfort, or whether this is the reality of the market that business growth is greatest in core service areas. In new service areas clearly the trend is toward the provision of broad range financial services.

Partner charge rates

The average partner charge rate across Australia was $150 per hour. This average came from a charge rate spread ranging from a minimum of $30 per hour to an upper end of $300 per hour. This indicates a significant difference in the range of work being undertaken and the client base of public practitioners.

The top quartile identifies a partner charge rate of greater than $175 per hour nationally, whereas firms in the bottom quartile reflect a charge rate of less than $120 per hour.

Partner charge rates by region

	ACT
	Total
Average	158
Minimum	100
Maximum	220
Bottom quartile	145
Top quartile	175

	NSW		
	Total	*CBD/Metro*	*Regional*
Average	144	149	131
Minimum	50	50	70
Maximum	300	300	170
Bottom quartile	120	120	120
Top quartile	160	167	150

	QLD/NT		
	Total	*CBD/Metro*	*Regional*
Average	138	151	129
Minimum	30	35	30
Maximum	285	285	230
Bottom quartile	101	101	105
Top quartile	160	180	147

	VIC/TAS		
	Total	*CBD/Metro*	*Regional*
Average	158	158	142
Minimum	50	80	50
Maximum	275	275	200
Bottom quartile	130	130	120
Top quartile	190	200	164

	WA/SA		
	Total	*CBD/Metro*	*Regional*
Average	152	156	138
Minimum	50	50	100
Maximum	220	220	175
Bottom quartile	125	137	125
Top quartile	175	180	155

Interestingly average charge rates across Australia have a relatively narrow spread. This may indicate that practitioners are setting charge rates on a ‘gut feel’ basis rather than applying any prescriptive methodology. Where charge rates are set based on a feeling of what other practitioners are charging, or what the market will bear, this can result in a relatively narrow charge band.

Labour and overheads

Labour

Payroll costs will vary from firm to firm. They will be influenced by the number and type of staff employed and also the number of principals or partners in the firm. Total labour costs are more difficult to measure where firms do not charge or impute a specific salary for a principal or partner. Clearly it is possible to skew your results in this area by either attaching a high partner salary or a low partner salary. We have commented later in this report on some generally accepted ways to overcome this problem to assist you in measuring labour cost on a consistent basis.

The survey provided the following information on labour costs:

- average labour cost on a national basis excluding principal or partners represents 31 cents in the revenue $;
- average labour costs on a national basis including principals or partners represents 55 cents in the revenue $;
- average labour costs across Australia sit in a relatively narrow band.

Labour by geographic region and practice type

	ACT	
	PR incl Ptnrs	*PR excl Ptnrs*
Average	0.52	0.20
Maximum	0.69	0.25
25th percentile	0.41	0.17

	Payroll incl Ptnrs	Payroll excl Ptnrs	Payroll incl Ptnrs	Payroll excl Ptnrs
	NSW - CBD/Metro	*NSW - CBD/Metro*	*NSW - Regional*	*NSW - Regional*
Average	0.55	0.30	0.50	0.36
Maximum	0.79	0.50	0.62	0.51
Top quartile	0.44	0.25	0.45	0.33

	Payroll incl Ptnrs	Payroll excl Ptnrs	Payroll incl Ptnrs	Payroll excl Ptnrs
	QLD/NT - CBD/Metro	*QLD/NT - CBD/Metro*	*QLD/NT - Regional*	*QLD/NT - Regional*
Average	0.59	0.35	0.52	0.32
Maximum	0.75	0.70	0.78	0.51
Top quartile	0.47	0.23	0.40	0.20

	Payroll incl Ptnrs	Payroll excl Ptnrs	Payroll incl Ptnrs	Payroll excl Ptnrs
	VIC/TAS - CBD/Metro	*VIC/TAS - CBD/Metro*	*VIC/TAS - Regional*	*VIC/TAS - Regional*
Average	0.56	0.32	0.40	0.24
Maximum	0.83	0.64	0.57	0.46
Top quartile	0.48	0.18	0.27	0.14

	Payroll incl Ptnrs	Payroll excl Ptnrs	Payroll incl Ptnrs	Payroll excl Ptnrs
	WA/SA - CBD/Metro	*WA/SA - CBD/Metro*	*WA/SA - Regional*	*WA/SA - Regional*
Average	0.59	0.29	0.56	0.34
Maximum	0.68	0.50	0.67	0.54
Top quartile	0.54	0.15	0.51	0.29

Overheads
On a national basis, overheads represent 30 cents in the revenue $. Across all practice types on a state by state basis there is not a significant difference between metropolitan and regional firms. When you break this down further between sole practitioner and partnership models there is a wider spread of results. Firms in the top quartile by profitability tend to achieve savings between five and ten cents in the revenue $.

Overheads by geographic region and practice type

	ACT-CBD	
	Sole Pract	*Partnerships*
Mean	0.36	0.25
Maximum	0.47	0.36
Top quartile	0.32	0.19

	NSW-CBD		**NSW Regional**	
	Sole Pract	*Partnerships*	*Sole Pract*	*Partnership*
Mean	0.28	0.33	0.25	0.36
Maximum	0.56	0.75	0.46	0.45
Top quartile	0.18	0.19	0.13	0.32

	QLD/NT - CBD		**QLD/NT Regional**	
	Sole Pract	*Partnership*	*Sole Pract*	*Partnership*
Mean	0.31	0.40	0.34	0.31
Maximum	0.64	0.49	1.43	0.41
Top quartile	0.20	0.35	0.21	0.28

	VIC/TAS-CBD		**VIC/TAS-Regional**	
	Sole Pract	*Partnership*	*Sole Pract*	*Partnership*
Mean	0.31	0.26	0.30	0.30
Maximum	0.72	0.42	0.52	0.53
Top quartile	0.22	0.20	0.17	0.25

	WA/SA-CBD		**WA/SA- Regional**	
	Sole Pract	*Partnership*	*Sole Pract*	*Partnership*
Mean	0.30	0.24	0.31	0.31
Maximum	0.61	0.40	0.50	0.42
Top quartile	0.17	0.13	0.23	0.26

Client sensitivity – Impact of fee revenue of top 5 clients

Where the gross fees of a firm are concentrated across a small number of clients, there is an increased business risk to the firm should one or more of those clients leave the firm. This risk is referred to as the client sensitivity of the firm.

The spread of fee revenue across a firm is generally quite wide. This reflects the broad client base of most firms and the willingness of firms to provide services to a mixed client base. CPA firms provide services to a mix of individual and business clients. As a result fee revenue can be concentrated with a relatively small number of clients accompanied by a long revenue tail as you move through the client base. Over recent years some firms have moved to tighten their client spread in order to achieve greater operating efficiency and a more targeted marketing message. The majority of firms however still retain a more traditional fee spread.

Client sensitivity for a firm has been measured by the relationship of the revenue contributed by the top 5 clients of the firm against the total revenue of the firm.

The survey results indicate that on a national basis the top 5 clients in a firm, on average, represent 20% of the fee base. The results tend to indicate that the larger states, by population, have a slightly higher level of client sensitivity. This ranges from 24% in NSW to 13% in the ACT.

Clearly the higher the concentration of fees in a small number of clients the higher the business risk for the firm, should a client leave. On the other hand the wider the client spread the greater the pressure placed on the firm to achieve operating efficiency.

A snapshot of the national results is as follows:

% of fees of top 5 clients to total revenue

Region	Average %	Minimum %	Maximum %	Top quartile %
National	**20**	**1**	**100**	**8**
ACT	**13**	**3**	**32**	**6**
NSW Total	**24**	**1**	**91**	**10**
NSW CBD/Metro	28	2	91	12
NSW Regional	18	1	56	9
QLD/NT Total	**18**	**1**	**100**	**8**
QLD/NT CBD/Metro	17	1	49	10
QLD/NT Regional	18	1	100	8
Vic/Tas Total	**20**	**1**	**100**	**8**
Vic/Tas CBD/Metro	22	1	100	10
Vic/Tas Regional	15	1	90	4
WA/SA Total	**17**	**1**	**100**	**8**
WA/SA CBD/Metro	19	2	100	8
WA/SA Regional	10	1	23	6

The minimum and maximum figures reflect some of the diversity of practices within the survey group. This diversity is reflected across the country. Practices range from the traditional firms with a wide client spread to firms where they only act for a small number of clients. In the majority of states the top 5 clients of CBD/metro firms represented a higher percentage of gross fees than their regional counterparts.

Is there a difference in client sensitivity between sole practitioner firms and partnerships? The answer seems to be yes. In the majority of cases major client sensitivity will be higher in sole practitioner firms.

Average % of fees of top 5 clients to total firm revenue – Sole practitioners / Partnerships

Region	Sole Practitioners	Partnerships
National	**21**	**15**
ACT	**14**	**10**
NSW Total	**26**	**19**
NSW CBD/Metro	28	27
NSW Regional	22	10
QLD/NT Total	**18**	**13**
QLD/NT CBD/Metro	17	16
QLD/NT Regional	19	11
Vic/Tas	**24**	**14**
Vic/Tas CBD/Metro	24	18
Vic/Tas Regional	23	7
WA/SA Total	**17**	**17**
WA/SA CBD/Metro	18	21
WA/SA Regional	12	7

What happens when you extend the client spread to look at the impact of the top 10 clients against total firm revenue?

Average % of fees of top 10 clients to total firm revenue

Region	Sole Practitioners	Partnerships
National	**30**	**23**
ACT	**21**	**15**
NSW Total	**35**	**27**
NSW CBD/Metro	37	37
NSW Regional	31	16
QLD/NT Total	**26**	**21**
QLD/NT CBD/Metro	27	26
QLD/NT Regional	26	17
Vic/Tas Total	**35**	**20**
Vic/Tas CBD/Metro	36	27
Vic/Tas Regional	31	10
WA/SA Total	**26**	**25**
WA/SA CBD/Metro	29	29
WA/SA Regional	19	11

The sensitivity and impact fall away reasonably quickly, however these figures indicate the significance of a small number of clients on the operation of the typical firm.

Liquidity

Liquidity of a professional services firm will generally be driven by the efficiency of management of their debtors and work in progress. A commonly accepted way to measure the efficiency of management of debtors and work in progress is to look at the average number of days it takes the firm to bill their work and then collect the bill.

The professions, accountants included, have not managed this well historically. It was not uncommon to see debtors and work in progress days well in excess of 90 for each area. This left the typical firm with a 'lock up' of around six months of revenue. As costs have risen and profits squeezed many firms have been forced to fund their operating position through either increased borrowings or a continued policy of profit retention within the firm. This can also be an inhibitor to growth due to the increased funding pressures placed on a firm.

In recent years many accounting firms have focused on this area to achieve greater efficiency with both their debtor and work in progress management. The survey results indicate that they are achieving strong progress.

Average debtor days

Region	Average	Minimum	Maximum	Top quartile
National	**43**	**1**	**125**	**30**
ACT	**49**	**30**	**90**	**33**
NSW Total	**43**	**5**	**120**	**30**
NSW CBD/Metro	44	5	116	30
NSW Regional	40	13	120	22
QLD/NT Total	**37**	**5**	**125**	**21**
QLD/NT CBD/Metro	40	5	112	20
QLD/NT Regional	35	7	125	22
Vic/Tas Total	**48**	**13**	**125**	**30**
Vic/Tas CBD/Metro	52	13	125	35
Vic/Tas Regional	38	14	66	29
WA/SA Total	**41**	**1**	**90**	**30**
WA/SA CBD/Metro	39	1	75	30
WA/SA Regional	48	14	90	38

Whilst the spread in the averages is relatively narrow, the spread between the minimum and the maximum is quite significant, as is the spread between the average and the top quartile against the maximum number of days.

Work in progress

In a similar way to the approach taken by firms in reducing the number of outstanding debtor's days there has been a change within the profession over the last five years with view to achieving a reduction in the time from when work is undertaken to when work is billed out. Increasingly firms have moved to either segment their work, leading to more frequent billing or alternately to enter into arrangements with clients to allow them progress bill on larger jobs.

Irrespective of the method the objective is the same – to drive down the number of work in progress days. Again this survey indicates progress is being achieved.

Average work in progress days

Region	Average	Minimum	Maximum	Top quartile
National	**47**	**1**	**183**	**25**
ACT	**49**	**30**	**120**	**30**
NSW Total	**45**	**4**	**110**	**20**
NSW CBD/Metro	46	4	110	30
NSW Regional	42	12	90	19
QLD/NT Total	**37**	**5**	**180**	**14**
QLD/NT CBD/Metro	40	10	180	15
QLD/NT Regional	34	5	140	14
Vic/Tas Total	**54**	**5**	**183**	**30**
Vic/Tas CBD/Metro	27	5	130	30
Vic/Tas Regional	65	5	183	30
WA/SA Total	**48**	**1**	**120**	**30**
WA/SA CBD/Metro	48	1	120	30
WA/SA Regional	47	20	90	28

The pattern shown here is similar to the debtors. The range in averages for work in progress days is reasonably narrow. Top quartile firms have achieved a high level of efficiency on the management of work in progress within their firms.

Labour efficiency

For the majority of professional services firms, labour efficiency is the key to their profitability. Whilst there are other factors such as charge rates, labour cost and overhead management, labour efficiency is the greatest determinant of firm profitability.

The majority of accounting firms 'sell time'. Their revenues are driven by the number of chargeable hours billed. There are some exceptions to this, including firms who undertake some level of value billing or where they are earning revenue streams from activities that generate any form of trail commissions or other annuity income. In the main though, chargeable hours are still the key driver of firm revenues.

The question for all firms is how many chargeable hours should they expect from their professional staff and what is the experience across Australia.

Time recovery % expected from professional staff

Region	Average %	Top quartile %
National	**76**	**80**
ACT	**69**	**80**
NSW Total	**76**	**80**
NSW CBD/Metro	78	80
NSW Regional	74	80
QLD/NT Total	**75**	**80**
QLD/NT CBD/Metro	76	84
QLD/NT Regional	73	80
Vic/Tas Total	**80**	**80**
Vic/Tas CBD/Metro	82	80
Vic/Tas Regional	77	80
WA/SA Total	**72**	**80**
WA/SA CBD/Metro	73	80
WA/SA Regional	71	83

The majority of firms have an expectation that their professional staff will produce a time recovery of around 75% of a standard week. The averages across Australia are relatively similar. Firms in the ACT, WA/SA have slightly lower expectations and firms in Victoria/Tasmania have the highest expectations. In the top quartile, expectations are reasonably consistent at the 80% level.

Budget hours expected for professional staff

How many hours do CPA firms expect from their professional staff?

Budget hours for professional staff

Region	Average	Top quartile
National	**1535**	**1725**
ACT	**1548**	**1600**
NSW Total	**1583**	**1800**
NSW CBD/Metro	1477	1663
NSW Regional	1753	1932
QLD/NT Total	**1567**	**1800**
QLD/NT CBD/Metro	1317	1680
QLD/NT Regional	1769	2016
Vic/Tas Total	**1494**	**1288**
Vic/Tas CBD/Metro	1481	1305
Vic/Tas Regional	1531	1263
WA/SA Total	**1528**	**1720**
WA/SA CBD/Metro	1434	1650
WA/SA Regional	1844	2106

Expectations are reasonably consistent across Australia. Regional firms have slightly higher expectations than their CBD/Metro counterparts. The average budget hours reflect that CPA firms look to their staff to work a standard working week. Based on a standard working week being 37.5 hours, and allowing for annual leave, statutory holidays and an allowance for sick leave, the standard budget for hours available would be 1650 hours. The survey results indicate that the average firm does not expect their staff to work excessive hours.

Top quartile firms tend to have higher expectations, other than in Victoria and Tasmania. Even in these cases the additional hours expected are not excessive. In many cases these additional hours would reflect demand during periods of seasonal spikes in work flow.

Budget time recovery % expected from principals and partners

In the typical CPA firm, revenue is significantly influenced by the chargeable hours achieved by the principals and partners. In most firms the principals and partners are actively involved in the chargeable work of the firm in addition to their administration, management and marketing roles.

What if any allowance do firms make for these additional roles that principals and partners undertake?

Time recovery % expected from principals and partners

Region	Average %	Top quartile %
National	**64**	**80**
ACT	**51**	**63**
NSW Total	**69**	**80**
NSW CBD/Metro	71	85
NSW Regional	67	77
QLD/NT Total	**62**	**74**
QLD/NT CBD/Metro	64	83
QLD/NT Regional	59	70
Vic/Tas Total	**61**	**75**
Vic/Tas CBD/Metro	28	65
Vic/Tas Regional	76	89
WA/SA Total	**70**	**80**
WA/SA CBD/Metro	71	80
WA/SA Regional	68	80

The general expectation across firms is that there is a small allowance to principals and partners in recognition of the broad range of client, staff and administrative functions that they undertake. In the top quartile this allowance largely disappears. Other than in the ACT this allowance is typically not greater than 10%. Regional firms tend to provide a greater allowance than CBD/Metro firms. A reasonable question to ask is whether principals and partners can manage their non chargeable roles through a reduced recovery allowance of 10% against other professional staff. The alternative is that they work much longer hours.

Budget hours expected of principals and partners

In the main CPA principals and partners are looking to achieve similar budget hours to their professional staff. No significant allowance is made for their non chargeable hours.

Budget hours by principals and partners

Region	Average	Top quartile
National	**1489**	**1850**
ACT	**1994**	**2140**
NSW Total	**1531**	**1988**
NSW CBD/Metro	1590	2000
NSW Regional	1442	1957
QLD/NT Total	**1493**	**1800**
QLD/NT CBD/Metro	1452	1678
QLD/NT Regional	1525	2120
Vic/Tas Total	**1438**	**1830**
Vic/Tas CBD/Metro	1444	1781
Vic/Tas Regional	1424	1920
WA/SA Total	**1457**	**1725**
WA/SA CBD/Metro	1395	1680
WA/SA Regional	1658	1775

To the extent that principals and partners need to allocate time to marketing, client relationship management, staffing issues and the other administrative and management demands of their practice, this time will be substantially in addition to their professional work. The expectation of the top quartile is generally 20-30% higher than the average.

Fee growth

The survey looked at the rate of growth being experienced by CPA firms and their expectations for the current year. The results indicate strong growth is being achieved.

Fee growth last year

Region	Average %	Minimum %	Maximum %	Top quartile %
National	**21**	**0**	**229**	**21**
ACT	**18**	**6**	**55**	**21**
NSW Total	**20**	**2**	**100**	**20**
NSW CBD/Metro	19	2	100	20
NSW Regional	21	3	80	20
QLD/NT Total	**18**	**0**	**100**	**22**
QLD/NT CBD/Metro	13	0	45	15
QLD/NT Regional	21	2	100	22
Vic/Tas Total	**25**	**1**	**229**	**20**
Vic/Tas CBD/Metro	22	1	150	20
Vic/Tas Regional	34	4	229	20
WA/SA Total	**20**	**5**	**100**	**22**
WA/SA CBD/Metro	18	5	71	20
WA/SA Regional	28	5	100	27

All regions are showing, on average, double digit fee growth over the last year. The range in fee growth is quite pronounced and this would be expected across a broad survey. It likely includes firms in their start up phase where growth in percentage terms will be quite pronounced, firms who have completed acquisitions or mergers and also mature firms.

This growth will have come from a mix of growth in fee rates, acquisition of new clients and demand for additional services from existing clients.

A national growth snapshot

Factor	Average	Top quartile
Average fee growth % last year	21	21
Expected fee growth % this year	22	20
% increase in charge rates last year	8	8
% increase in charge rates this year	9	7
No. of new clients last year	76	61
No. of clients lost last year	32	36

The snapshot indicates that CPA firms are growing. The average firm has achieved double digit growth in the last year and expects this trend to continue. Growth is coming through a reasonable level of price growth, but predominately from the acquisition of new clients and the provision of additional services to existing clients.

Natural growth continues. Firms will always lose clients for a wide range of reasons. Relocation, retirement, sale of business is common factors. In some cases firms who are looking to a more targeted approach to their client base will cease to provide services to some client groups. It is evident in the last year that some firms have rationalised their client base.

In comparing the average firm with those in the top quartile by profitability it is interesting to note the following:

- growth in top quartile firms is consistent with the average;
- fee rate growth is reasonably consistent;
- top quartile firms have acquired fewer new clients;
- top quartile firms have lost slightly more clients.

This tends to suggest that profitability comes from a more focused approach to the clients that a firm is dealing with. Profitability in these firms is not simply being driven by growth in fee rates or through rapid acquisition of new clients. They appear to have a much more selective approach to the clients they take on and then seek to maximize the services they provide to that client base. Fee growth in these firms is far more focused on bottom line growth than top line growth.

Concerns about risk

Most surveys look at performance, trends and outcomes. In this survey we also asked participants to identify areas where their business could be impacted by 'risk' events. They did this by responding to a range of scenarios and ranking them as low, medium, or high impact events for their firm.

Rating of practice risk events

Event	Risk rating %		
	Low	*Medium*	*High*
Retirement/ resignation of a partner	24	8	68
Sickness or accident causing partner absence for 2 months	14	23	63
Merger	29	25	46
Loss of a key team member	24	33	43
Professional negligence claim	28	29	43
Need to invest in practice $50-100K	33	29	39
Increase in ATO audit activity	32	35	33
Significant increase in work requirements for key clients	18	52	30
Change in office premises	35	35	30
Acquisition of a major new client	25	49	27
Loss of two top 5 clients	39	36	25
Loss of a top 5 client	45	34	21
Reduction in profits by 5-10%	42	39	19
Increase in working capital of 10%	46	38	16
Reduction in profits by up to 5%	64	26	10

The high risk events stand out clearly. The top 5 are:

- retirement/resignation of a partner (68%);
- sickness or accident causing a partner absence for 2 months (63%);
- merger (46%);
- loss of a key team member (43%); and
- professional negligence claim (43%).

Firms are concerned about maintaining continuity within their ownership, their structure and their team. They recognise that changes in any of these areas will likely impact the firm adversely, at least in the short term. Pressures in financial and client management areas are seen as being more manageable.

Financial planning

In terms of new services introduced, financial planning has been a growth area for practitioners over the last decade. Many CPAs provide financial planning advice to their clients directly or have arrangements in place to facilitate the provision of this advice. More recently the introduction of the Financial Services Reform Act and the increasing requirements placed on participants in this area has raised the question about how accountants will best deliver this service to their clients.

Survey participants were asked to identify whether their firm provided a financial planning solution for their clients. The results were:

	Yes %	No %	DNR %
All firms	54	43	3
Top 25% of firms by profitability	59	39	2

Clearly, there is an increasing trend for CPA firms to provide a financial planning solution for their clients. In the more profitable firms there is a slightly higher incidence of the provision of this service.

What about the future?

Participants were also asked to respond to some future issues. These largely revolved around succession and practice direction. The responses provide some indication of future direction.

Future practice direction and intentions

	Yes %	No %
Do you intend to change your practice's business model in the coming year?	25	71
Do any of the partners within your firm plan to retire within the next 5 years?	25	70
Do you intend to sell your practice within the next 5 years?	19	78
Do you intend or are you looking to merge with another firm?	19	76

The key message coming from these responses is that we are going to see an active market of change within CPA firms over the coming 5 years. Succession is an increasing issue and many firms will need to plan for and deal with how they will facilitate this change. The statistics suggest that one in every four firms is approaching a major change event of some sort.

Section 2

A deeper look at the survey results

The raw numbers out of the survey provide a level of information. Through further analysis we can draw more information and understanding from the survey results. This analysis provides us with both current information on the performance of the profession and also an indication of emerging trends and issues.

In undertaking this further analysis we have focused around the four key themes of:

- profitability;
- liquidity;
- efficiency; and
- growth.

Thereafter we have looked at the future and what the issues and trends are likely to be for the profession.

Some highlights from this section include:

- how profitable are CPA firms?;
- performance measures to assist you in assessing your firm and its partners;
- staffing models that work;
- where the trends are in services being provided;
- a closer look at charge rates;
- cost benchmarks for labour and overheads;
- reasonable profit expectations; and
- how succession is going to impact the profession.

Profitability

One of the most reliable measures of profitability in an accounting firm is the revenue per full time equivalent. Typically accounting firms manage their cost structure quite well. It is rare to see a firm where there is significant expense over runs or wild extravagances. Generally speaking we are good expense managers. So the bottom line will be most impacted by revenue efficiency.

Gross revenue per full time equivalent

Given the most significant expense for an accounting firm is labour cost, a reliable KPI of business performance is the gross revenue achieved per full time equivalent. This measure is calculated by dividing your gross fees by the total full time equivalent (FTE) personnel in your firm. It includes principals and partners, professional and support staff, both chargeable and non chargeable. Where you engage part time or casual staff you need to calculate their full time equivalent rate e.g. a person working part time, 20 hours per week would be calculated at .53 FTE (20/37.5, assuming a 37.5 hr. week).

The survey produced the following results:

- average gross fees per FTE nationally was $79,877;
- top quartile firms nationally achieved better than $98,750;
- the best performance recorded was $240,000.

Gross revenue per full time equivalent (FTE) by region

	$ Gross Revenue per FTE		
Region	*Average*	*Top performer*	*Top quartile*
ACT	**80,049**	**115,520**	**101,071**
NSW Total	**77,699**	**137,500**	**93,268**
NSW CBD/Metro	78,296	137,500	100,000
NSW Regional	76,540	113,876	87,244
QLD/NT Total	**66,709**	**180,000**	**77,617**
QLD/NT CBD/Metro	72,323	180,000	76,900
QLD/NT Regional	62,967	118,499	77,938
Vic/Tas Total	**86,035**	**201,000**	**103,977**
Vic/Tas CBD/Metro	88,637	201,000	109,069
Vic/Tas Regional	78,454	182,000	87,265
WA/SA Total	**86,122**	**240,000**	**100,000**
WA/SA CBD/Metro	89,510	240,000	100,000
WA/SA Regional	76,199	133,333	97,083

Results are quite mixed across Australia. The eastern states where it is often assumed that charge rates are the highest don't out perform WA and SA. The gap between the average firm and the top performer is substantial. Even between the average and the top quartile firms in each region there is a spread of up to $20K plus, per FTE. Much of this difference goes direct to the bottom line. This indicates that the significant spread in profitability of accounting firms that existed historically continues.

Do the numbers vary between sole practitioners and partnerships? Let's have a look.

On a national basis the key figures look like this.

Gross revenue per full time equivalent (FTE) nationally

	Sole Practitioners	Partnerships
Average	75,528	91,638
Best performer	240,000	201,000
Top quartile	93,500	104,949

Partnerships on average achieve better results and have a higher upper quartile performance. Best performance however, is reserved for a sole practitioner.

Gross revenue per full time equivalent (FTE) by structure

	NSW-CBD		NSW Regional	
	Sole Pract	*Partnerships*	*Sole Pract*	*Partnership*
Average	75,578	88,391	74,293	80,660
Best performer	137,500	134,729	113,876	98,334
Top quartile	97,850	97,500	81,289	91,711

	QLD/NT - CBD		QLD/NT Regional	
	Sole Pract	*Partnership*	*Sole Pract*	*Partnership*
Average	73,490	64,152	61,701	69,297
Best performer	180,000	70,990	118,499	83,077
Top quartile	77,600	66,787	76,500	78,413

	VIC/TAS-CBD		VIC/TAS-Regional	
	Sole Pract	*Partnership*	*Sole Pract*	*Partnership*
Average	79,938	112,318	79,362	77,621
Best performer	195,169	201,000	182,000	105,000
Top quartile	100,000	135,690	96,954	77,670

	WA/SA-CBD		WA/SA- Regional	
	Sole Pract	*Partnership*	*Sole Pract*	*Partnership*
Average	88,351	91,744	61,051	103,467
Best performer	240,000	150,000	109,610	133,333
Top quartile	100,000	105,880	80,000	125,000

In the main, partnerships out perform sole practitioners and CBD/Metro firms achieve higher gross revenue to FTE than regional firms. Regional partnerships in WA, SA and QLD are an exception to this trend. In general you would expect CBD/Metro firms to out perform regional firms on a gross revenue basis. Typically their labour and overhead costs would be higher, so this difference does not automatically carry forward to the bottom line.

The market generally acknowledges that the broad objective in this area is to achieve gross revenue per FTE in excess of $100K. The imperative to do this is greatest in firms statistically in the Sydney and Melbourne markets where labour costs are the highest.

The following assessment guide to profitability on revenue per full time equivalent assists in understanding the business impact of getting this indicator right.

Guide to profitability on revenue per FTE

Less than $60,000	Very low profitability, practice at risk, likely to experience constant liquidity problems.
$60,000 to $80,000	This is in the average band in Australia. Your profitability is below the level necessary to provide you with a reasonable return. You will have liquidity pressures at times of practice reinvestment or with problem debtors.
$80,000 to $100,000	You are in the better performing group. You achieve a reasonable return and can generally manage practice reinvestment. Your only pressure comes on during high growth periods. You are well placed for the next step.
$100,000 to $120,000	You are in the top 15% in Australia and right up there with the big firms. You should be achieving good returns and liquidity should be strong and capable of managing growth.
$120,000 plus	You are a boutique firm and likely in the top 3%. Keep on doing what you are doing.

Keys to achieving this profitability are:

- ensuring charge rates are set to market;
- achieving effective labour efficiency;
- keeping write off levels below 8%;
- managing work flow consistently across the year;
- having the right client mix; and
- having the right staff mix for your work program.

Fees managed per principal/partner

A further guide to profitability is usually found in the amount of fees managed per principal/partner. One of the reasons this is a reliable guide is because typically the most expensive labour cost for a firm is the principal or partners. The greater the fee base this cost is spread across, the higher the profitability. Clearly a balance is needed here between maximising profitability and at the same time ensuring that there is appropriate quality control in place. Principals and partners can be spread too thinly.

The ratio of fees to principal/partner will vary throughout the life of a firm. During periods of growth the ratio will move from a low number to a high number. When new partners are introduced to the firm, and unless accompanied by a corresponding level of new fees, it is normal to see a temporary drop in the gross fees per partner. The critical number to consider here is not so much a ‘spot’ number i.e. the measurement at any instant of time, but rather to measure the trend.

On a national basis the survey produced the following results.

Gross fees managed by principal/partner nationally

	$ gross fees managed per principal/partner	
	Sole Practitioners	*Partnerships*
Average	286,923	357,584
Maximum	1,067,829	856,667
Top quartile	400,000	453,486

Against broader industry measures, the average and top quartile numbers are low. This possibly reflects the influence within the survey of sole practitioners employing no staff, and firms that are going through growth cycles at the moment and where numbers are lower due to the introduction of new partners. Mature, small medium firms would normally look for principals or partners to manage fees of $750K or more. Firms can certainly be profitable at lower levels than this and not all firms are looking to grow. In some instances, particularly sole practitioners, a deliberate decision may be taken not to grow the firm, and rather maintain it at an optimal profit level for the principal.

Gross fees managed by principal/partner by region

	NSW-CBD		NSW Regional	
	Sole Pract	*Partnerships*	*Sole Pract*	*Partnership*
Average	275,727	236,699	198,824	310,594
Maximum	920,000	377,240	452,000	590,005
Top quartile	455,250	312,500	251,000	309,020

	QLD/NT - CBD		QLD/NT Regional	
	Sole Pract	*Partnership*	*Sole Pract*	*Partnership*
Average	324,532	324,568	281,347	264,805
Maximum	683,597	333,667	853,000	405,088
Top quartile	498,000	332,477	395,000	329,936

	VIC/TAS-CBD		VIC/TAS-Regional	
	Sole Pract	*Partnership*	*Sole Pract*	*Partnership*
Average	281,279	463,891	206,328	353,679
Maximum	1,000,000	679,937	528,000	665,056
Top quartile	355,000	620,150	226,897	421,250

	WA/SA-CBD		WA/SA- Regional	
	Sole Pract	*Partnership*	*Sole Pract*	*Partnership*
Average	299,019	313,310	367,320	370,000
Maximum	1,000,000	583,333	994,052	600,000
Top quartile	413,087	440,625	400,000	530,000

The gross fees managed per principal/partner is not only a valuable measure to understand the leverage of the time of the principal/partner but it is also a useful measure if you are contemplating the admission of new partners to a firm. Firms can become over partnered and this leads to a dilution of profits at partner level.

Number of client groups managed per principal/partner

How many client groups do principals/ partners manage and what is a reasonable expectation?

Clearly the answer will vary depending on the type of clients that are cared for by the firm. The smaller the client size the greater the number of clients that would be under the care of a principal or partner.

Client groups per principal/partner nationally

	Number of client groups per principal/partner	
	Sole Practitioners	*Partnerships*
Average	291	314
Maximum	1800	2000
Top quartile	400	350

Client groups per principal/partner by region

	ACT-CBD	
	Sole Pract	*Partnerships*
Average	539	565
Maximum	1,550	979
Top quartile	708	772

	NSW-CBD		NSW Regional	
	Sole Pract	*Partnerships*	*Sole Pract*	*Partnership*
Average	191	289	269	237
Maximum	800	1,000	1,200	625
Top quartile	308	250	400	414

	QLD/NT - CBD		QLD/NT - Regional	
	Sole Pract	*Partnership*	*Sole Pract*	*Partnership*
Average	372	308	418	178
Maximum	1,100	833	1,500	363
Top quartile	700	442	650	338

	VIC/TAS-CBD		VIC/TAS-Regional	
	Sole Pract	*Partnership*	*Sole Pract*	*Partnership*
Average	164	219	453	398
Maximum	800	1,000	1,800	1,000
Top quartile	250	238	750	395

	WA/SA-CBD		WA/SA- Regional	
	Sole Pract	*Partnership*	*Sole Pract*	*Partnership*
Average	315	255	181	967
Maximum	1,400	1,000	350	2,000
Top quartile	358	277	275	1,900

The relationship between the number of client groups managed and profitability needs to be considered in light of the type of work being undertaken by the firm. This comes back to looking at your business strategy. Where the focus is on business clients it is unlikely that a principal or partner could manage much more than 200 client groups. Where there are a reasonable proportion of larger clients, this number may not be achievable. One way to test this is to look at the fee base coming off the client groups. Once your fees are in the $750K to $1m range then you are reaching capacity. Where a firm has a large individual client base, it may be more difficult to achieve these numbers unless you have significant leverage in place.

Gross fees per tax return

This measurement would be most meaningful for those practices that are heavily compliance driven. Again the key number to measure here is not so much the 'spot' number but rather to measure the trend that is occurring. Ideally the number would be increasing. Such an increase would be a sign of increasing charge rates, your client mix moving toward higher value work, and improved efficiency.

Gross fees per tax return by structure nationally

	Sole Practitioners $	Partnerships $
Average	712	988
Best performer	15,000	20,000
Top quartile	656	914

The upper end numbers are less meaningful as they are examples of small or boutique style firms. They do provide a picture though of the mix that exists in public practice firms across Australia.

Gross fees per tax return by structure by region

	ACT-CBD	
	Sole Pract	*Partnerships*
Mean	836	566
Maximum	3,051	601
Top quartile	648	583

	NSW-CBD		NSW Regional	
	Sole Pract	*Partnerships*	*Sole Pract*	*Partnership*
Average	1,383	570	375	463
Best performer	10,000	1,267	734	1,038
Top quartile	1,111	807	453	633

	QLD-NT/CBD		QLD/NT Regional	
	Sole Pract	*Partnership*	*Sole Pract*	*Partnership*
Average	609	981	377	411
Best performer	4,220	1,656	932	800
Top quartile	564	1,358	518	533

	VIC/TAS-CBD		VIC/TAS-Regional	
	Sole Pract	*Partnership*	*Sole Pract*	*Partnership*
Average	925	1,024	347	456
Best performer	15,000	3,387	880	1,420
Top quartile	825	1,021	472	491

	WA/SA-CBD		WA/SA- Regional	
	Sole Pract	*Partnership*	*Sole Pract*	*Partnership*
Average	597	2,346	321	301
Best performer	2,363	20,000	572	421
Top quartile	750	1,000	390	359

Liquidity

CPA firms across Australia have focused on the liquidity issue over recent years. And the survey results indicate that many of them are achieving 'best practice' results.

Historically the accounting profession has accepted average debtor days and work in progress days at 90 being the norm. The resulting six months of work in lock up has placed pressure on cash flow and funding for growth. At times we have been tardy in getting our bills out to the clients and reluctant to follow up clients to ensure that fees are collected within reasonable time.

The current survey indicates that all of this is changing.

Looking at debtors, a national average of 43 days and a reasonably consistent spread across the country indicates that CPA firms are managing their debtors reasonably well. Some of the old habits die hard and it is still evident across the survey that some firms are experiencing debtor averages between 90 and 125 days. These firms will be experiencing cash flow pressures or have a significant amount of capital tied up in funding the firm.

A current benchmark that many firms are working to is to have their debtors within a 45 day average.

Work in progress management is also much more efficient. The national average now sits at 47 days. In a number of cases we are seeing firms manage their work in progress within a 30 day average. Firms who have changed their work flow management practices still labour in this area. Across Australia the survey indicates that there are still firms with average work in progress days in the range of 90 to 180.

The current benchmark objective for many firms is to have their work in progress within a 30 day average.

Looking at the top quartile firms who are reporting in this survey they all have their debtors and work in progress well managed. In virtually all cases and regions top quartile firms are managing debtors and work in progress within an average 30 day cycle. When you look at this statistic across all of the reporting regions and the relative consistency that shows in best practice it is evident that this is not the domain of a specific demographic of firm. Irrespective of city or country, large or small, there are firms who have this area managed very well.

Staffing

People are the key resource of a CPA firm.

Accepting that most firms charge on a time basis, then chargeable hours becomes a key driver in your revenue realization. Corresponding to this labour cost becomes the highest cost area of the business. Two areas coming out of the survey that are worth considering is the level of leverage being achieved by firms through their staff, and the issue of staff turnover and its impact on the firm.

The survey indicates that the average firm is working with a principal or partner to staff ratio between 1 in 4 and 1 in 5. Does this staff ratio provide sufficient leverage?

The two ingredients that contribute to profit in a firm are price and leverage. If we accept that there is a physical limit to the number of hours worked by anyone (principals and partners included) then the profit of a firm will be driven by the charge rate achieved and the leverage in place. The survey indicates that the majority of firms work within charge rates that would be regarded as normal in the market. Only a few firms are achieving premium pricing. The vast majority are in the mid range area. Allowing for this then profit return will flow from hours worked and the leverage achieved.

Current benchmarks suggest that a partner to staff ratio of 1:7 is the ideal. This is a general benchmark and will vary with different styles of firms and services being provided. It does however hold true for the typical business services firm.

Applying this benchmark indicates that the typical CPA firm would achieve an improvement in their profitability with a slightly higher leverage ratio than presently exists. This leverage may also assist in work segmentation and achieving a better recovery rate. The right staff mix will be influenced by the nature of work undertaken. Where the work program is dominated by standard compliance work then an appropriate staff mix would be:

- Partner
- Manager – 1
- Seniors – 2
- Graduates/Intermediates - 3
- Support – 1

Where the work program is influenced more by advisory work than base compliance work, the staff mix would vary to reduce the number of graduates with a corresponding increase at the senior/manager level.

The survey indicates that staff turnover whilst evident in CPA firms, is not at an unreasonable level.

Staff turnover can have a significant impact on practice profitability and efficiency. Every time a new person joins the firm there is a need to progress through an induction period that allows them to understand the firm, the people within the firm, the systems and operating procedures, and the clients. This will always impact on efficiency. An objective coming out of this should be to drive down the staff turnover rate as much as possible. To achieve this, consideration needs to be given to:

- providing a positive work environment;
- providing work that is both interesting and challenging;
- ensuring that your remuneration system is competitive to the market;
- providing professional development and growth;
- being able to offer a career path; and
- providing effective performance feedback and guidance.

Service areas

Compliance work is not dead, quite the opposite, in fact. The survey indicates that taxation and accounting compliance services are the dominant service areas for CPA firms. What's more they are the two areas where the majority of firms saw the highest growth in the last year. 52% of all firms participating in the survey cited one of these areas (42% tax compliance and 10% accounting compilation) as their highest growth areas. This is perhaps not surprising given the complexity of our tax legislation and the continuing challenges of our New Tax System, for businesses throughout Australia.

This does not mean however that growth isn't being experienced in other areas. The survey provides clear evidence that many CPA firms are delivering a broad range of business and consulting services. These service areas are quite widely spread. 48% of survey respondents identified the highest growth areas for their firms were in non compliance services. High growth areas included business advisory services, financial planning, superannuation, audit and management accounting.

Firms that rank in the top quartile by profitability also indicated that tax compliance and accounting compilation were high growth areas. The differences that are noteworthy with these firms include:

- tax and accounting represent a lower percentage of their fee base;
- they typically provide a broader range of services;
- they have a lower incidence of reporting their highest growth area as being in compliance services, compared to all firms; and
- many of these firms deliver one or more specialist services.

In terms of expectation for the coming year all firms, including firms that rank in the top quartile of profitability, nominate tax compliance and financial planning as the areas where they anticipate achieving the highest growth.

The financial services area is the one where CPA firms are most likely to focus when they consider the introduction of new services. The survey indicates the services most introduced in the last year were:

- financial planning; and
- finance advice/broking.

This appears to be where the market is moving.

Partner charge rates

It may be time for firms to look more closely at their charge rates, and in particular partner charge rates. In the typical accounting firm charge rates will be heavily influenced by the partner charge rate. All other charge rates cascade downwards from there.

The survey indicates that the average partner charge rate being applied across Australia is $150 per hour, with the top quartile commencing at $175 per hour. This relatively narrow band between the average rate and the top quartile indicates that a significant number of firms have their rates set in this general area. Review of partner charge rates is an area that is easy to overlook when you are busy.

It is important to review partner charge rates on a regular basis to ensure that your rates appropriately reflect the work you are doing, the market you are working with and your level of experience and expertise. There are a number of methods that are commonly employed in establishing charge rates. These include:

- a multiple of salary approach;
- a cost plus approach. This method works up the cost model for the firm and then set charge rates against costs plus a pre determined margin;
- a profit achievement approach. This model determines the profit required by the principals or partners, layers in all other costs and then sets charge rates to a level appropriate to generate the economic return required;
- establish partner rates and then set all other rates as a percentage of the relevant partner rate.

Each method has its own merits and can be used effectively. Irrespective of the method employed the important factor is to ensure that charge rates are reviewed regularly and set at a rate appropriate to your market and adequate to provide a reasonable return for your business.

Looking at the profitability of firms when measured under the Gross Fees per FTE method, the profit levels on average are slightly below industry expectations. Whilst a number of firms are achieving excellent results the average indicates that many firms are less profitable than would seem reasonable for the effort, risk and experience that are being invested in the operation of their firm. A significant contributor to this is the charge rates being applied. A relatively small movement in charge rates can have quite a significant impact on bottom line return.

The cost structure of the typical CPA firm is continuing to rise. This requires continuing review of charge rates to ensure they appropriately reflect changes that may have occurred in your business.

Profit, labour and overheads

What are reasonable profit expectations for a CPA firm?

The answer to this will vary somewhat depending on the type of firm and the services being provided. Interestingly it is not necessarily influenced by geographic location or size. These factors can contribute to your results but they will not determine them. The survey indicates that high profitability is being achieved by firms in all parts of the country, but not all firms are profitable. Similarly profit is not dictated by whether you are a sole practitioner or a partner in a larger firm. Both groups reflect good and bad results.

A dominant factor to profitability is the range of services provided and levels of specialisation. Firms that are effectively providing broader or deeper services tend to be more profitable than firms where the service offering is restricted to general compliance services.

The cost of labour will be the dominant cost in a CPA firm. **Including a salary for principals or partners, firms should be looking to have labour costs sitting within the range of 58 cents to 65 cents in the revenue $.** This cost includes salary plus direct labour on costs e.g. superannuation, workers compensation, payroll tax etc. Where firms do not allocate a fixed salary cost for the principal or partner, this figure can be skewed somewhat. As a guide where you are seeking to impute a notional salary for a principal or partner for calculation purposes, allow whatever you would pay a senior manager in your firm plus a loading of 20%.

The objective with overheads would be to contain them within a band of 22 to 28 cents in the revenue $. Looking at the survey, the national average shows a slightly higher weighting at 30 cents. Overhead pressure will be higher for firms who are located in high rent areas, such as CBD locations, or where they are going through a growth phase and are putting capacity in place to accommodate further growth. Overhead pressure on profitability can also be experienced where charge rates and in turn revenues are below an appropriate level.

The survey indicates that some firms are managing overheads very well and the majority of the top quartile firms by performance are well within the best practice benchmark guidelines.

Allowing for these benchmark guides you are able to calculate reasonable profit returns for a CPA firm. Based on the current, broader market and allowing for reasonable benchmarks on labour and overheads, profit returns achievable should be in the following ranges:

- **for firms primarily delivering compliance services – 10 to 14 cents in the revenue $ after allowing for principal/partner salaries.**
- **for firms delivering broader range or specialist services – 15 to 20 cents in the revenue $ after allowing for principal/partner salaries.**

Succession planning

This looms as the dominant strategic issue for CPA firms over the next five years.

To understand this you only have to look at three unrelated responses coming form the survey.

1. 40% of survey respondents are over the age of 50, with 8% being 60 years plus. Broader industry statistics indicate that in excess of 50% of public practitioners are over the age of 50.
2. 19% of survey respondents indicated that they intend to sell their practice within the next 5 years and 25% of firms indicated that at least one partner in their firm planned to retire within the next 5 years.
3. The highest risk concern of survey respondents was the retirement or resignation of a principal or partner.

The succession issue for CPA firms is consistent with the broader SME market. What we are seeing is the baby boomer generation of public practitioners moving through the system, and now in a decade where they are considering retirement. The demographic of the public practice market is one dominated by sole practitioners and 2-3 partner firms. The survey response was consistent with this demographic – 73% of respondents were sole practitioners and a further 22% were two and three partner firms. This demographic reflects a highly fragmented market that is dominated by a lot of small practice units.

A key consideration from the survey is what will happen in this market when a significant percentage of practitioners seek to exit over a short period of time. Clearly there is going to be major movement and change. If the survey responses become reality then over the coming 5 years we will see the most significant change in ownership of practices and the largest movement of client management that has ever occurred in the profession in Australia. All firms need to consider how they will respond to this.

For practitioners who are looking to sell or retire over the next five years, economic theory on supply and demand may come into effect. An increasing supply of firms or parcels of fees may push prices down. Whilst this may occur, the more likely scenario is an increasing polarisation of price between firms. Profitable, well managed firms will always be in demand. Less profitable and marginal firms will be under pressure and in extreme cases may become unsaleable. Increasingly we will see buyers more focussed on the profitability of a parcel of fees than they are on simply the headline number of the gross fees. Pricing models that are expressed as a percentage of annual gross revenues will be heavily influenced by the profit returns being generated.

The survey indicates that practitioners need to develop their succession plans and start to prepare for a period of major change. The highest risk rests with those firms who are significantly under performing the market or who are unprepared for succession. Irrespective of whether you have a succession issue looming in the next five years, you will be affected by the change in the market.

Ongoing research and benchmarking

The CPA Benchmark Survey of Public Practice in Australia will be produced regularly to provide meaningful and current information to practitioners. In addition, survey results will be tracked to identify trends, issues and opportunities within the profession.

We encourage the participation of all CPA member practices in the next survey. The greater the number of practices involved, the more meaningful the data we obtain from which to track trends within the industry.