INSIDE Public Accounting

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December 2006
Volume 20, Number 12

Incorporating "TIP" Clauses In CPA Firm Engagement Letters: An Innovative Pricing Concept From VeraSage Founder Ron Baker

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INSIDE PUBLIC ACCOUNTING *recently had a chance to talk with Ronald J. Baker, CPA, founder of VeraSage Institute. Baker shares his views on "TIP" clauses – a fascinating alternative pricing strategy for the accounting profession that is as controversial for some as it is successful for others.*

Q: What exactly is a TIP clause? TIP comes from the acronym "To Insure Performance." A TIP clause – also called the retrospective price or success price – can be used when a CPA firm is performing an extraordinary service for a client, like helping sell a business. CPAs are not going to get a TIP for doing a tax return. The TIP clause basically says, "Mr. Client, we'll do whatever it takes to accomplish your goals, and we'll let you decide at the end what you want to pay us." It's allowing the client to pay you based upon their satisfaction with your services, and/or the results that you achieve. Now there are all sorts of ways to do that. You can set a minimum price plus a TIP, for example. Across the board, accountants undervalue their work because they are mired in the mentality of pricing based upon the billable hour. I think it's just ludicrous.

Q: What are some success stories that you can share? The biggest success I know of is from Gus Stearns, a CPA in Dallas. He was involved in a complicated tax issue for a client and would have charged $180,000 based on the standard rate of $180 an hour. Instead, he asked the clients what they thought his work was worth. They ended up giving him a structured deal. They put him on the payroll, put him in the pension, and paid him annual payments in the total of $1.1 million over seven years.

Would the $180,000 have been profitable? *Absolutely*. He would have made money, but how much money would he have left on the table? The TIP clause allowed him to capture some additional value. No one is suggesting that you can capture 100 percent of the true value, but you can certainly capture more than an hourly rate.

Q: When and where did you start seeing TIP clauses in the accounting profession? My dad's a barber so he always got tips. A tip is just a way of saying, "Hey, look, you added more value than your price." I was thinking, how can we take this custom and turn it into a pricing strategy? I started using them in my firm in '94 or '95. I worked on a nasty divorce for a client – I knew it was going to be *The War of the Roses* – but both spouses trusted me with the numbers to divide the assets. I told them I'd let them pay me what they thought it was worth. Well, turns out that they didn't use the information. Both attorneys thought they could do better, but they paid me $15,000 because they still thought it was worth it. It was incredibly interesting to me. I might have put five or seven hours including meetings into this. That was really when it hit me in the face that some of the things we do are so valuable, and yet we project our price sensitivity onto our clients. Maybe you spend only a couple of hours on something incredibly valuable, but it's valuable because you've spent a lifetime accumulating wisdom, experience and judgment.

Tight Deadlines Equate To Greater Value For Clients

Q: What kind of services would be appropriate for TIP clauses? I think any professional service firm could use this. We've seen them used for selling a business, or turning around certain work in record time. I know of a client calling one of my colleagues at 7 at night, in the heat of tax season, while he was at his son's baseball game. The client wanted a personal financial statement in 12 hours so he could bid on his wife's dream property at auction the next morning. Normally, given two or three weeks time, it would cost $2,500, but he let the client decide on the price. Although he didn't get the financing, he gave the firm $15,000 because they did a great job.

Q: What perceptions need to change in order to assimilate this concept into a firm's pricing mix? The firm can't charge by the hour. If the firm charges by the hour, its probability of succeeding with the TIP is severely diminished because what the client can say to the CPA when they bring up the TIP suggestion is, "Well, wait a minute, you charge me by the hour for everything, so I'll just pay you your hourly rate." We need to communicate to the client our value and we need to price accordingly. Profits come from risk, and if firms are not willing to price like every other business prices, which is up front and based on value, they'll never reap the rewards.

Q: What state regulatory issues need to be considered, if any? None, other than complying with professional standards. You obviously can't do some type of TIP that's based on a contingency or a percentage of a financial outcome if it's an audit client. In that case, the TIP clause can be based on their satisfaction with your services. Other than the contingency/independence issue, there aren't any regulations against it.

CPAs Are Knowledge Workers, Not Union Workers

Q: What prerequisites might need to be in place prior to the addition of a TIP clause? Don't bill by the hour. That's a huge prerequisite. This is an advanced pricing strategy, this isn't for wimps and this isn't for beginners. This is really for people who understand and can articulate the value they bring to clients, and quite honestly 90 percent of firms can't do this. They think they sell time. They'll never take the leap. Ask yourself, "What's the risk of charging by the hour?" TIP money can be distributed to the team in bonuses or trips, which goes back to quality of life issues. Firms have trouble attracting and retaining people because they work their people like galley slaves on the *SS Billable Hour*. They think the only value people bring is in how many hours they work. CPAs are knowledge workers, not union workers.

Q: What is the typical (if there is such a thing) wording of a TIP clause? I've included an example of the wording of a TIP clause in the book, *The Firm of the Future* which I co-authored with Paul Dunn: "In the event that we are able to satisfy your needs in a timely and professional manner, you have agreed to review the situation and decide whether, in the sole discretion of [client name], some additional payment to [firm name] is appropriate in view of your overall satisfaction with the services rendered by [firm name] and/or the financial results achieved by [client name] for this transaction." (Note that this wording would have to be changed for audit clients because it is illegal to base the TIP on a financial outcome or a contingency).

Q: Have there been any challenges to this practice from the AICPA or others? When I first presented this to firms with 50 partners and above in 1999 or 2000, they flipped. They thought it was absolutely illegal because they thought it impaired independence. I challenged all of them to let me know the code section that says I can't get a TIP the way I'm structuring it. Well, it's been six years and I haven't heard a peep. There's nothing illegal, or unethical, about it.

Up Front Client Communication Is Vital For Success

Q: When do you communicate the concept to clients? Communicate up front because a service that is needed is always worth more than a service that has been delivered. The 'when' is critical here, and this is where most firms fall down. They do it 'during' the engagement, or they do it 'after' and it's too late. The horse is out of the barn.

Q: What has been a typical client reaction to this non-traditional approach? These are usually good, long-term clients, and they generally have some sense of the value. If you're doing something extraordinary, they're not going to want to insult you. This is where you have to use judgment. Some clients will get uncomfortable, but at least you'll have a discussion about it up front and you can throw out a number, and you'll probably get at least that.

Senior Partners Best Understand Their Value To Clients

Q: What types of firms would be successful with using TIP clauses? It works best with firms that have a value-pricing culture, not an hours culture. A lot of successful TIPs we've seen are with the older partners because they've been around longer and they're more comfortable with the value of what they do.

Q: How widespread is the concept in the accounting profession? There are roughly 90,000 accounting firms in the English-speaking world, and 7 to 10 percent of those firms are using value pricing the way we teach it, which is pricing up front, using fixed-price agreements, change orders, and innovative pricing strategies like the TIP clause. A percentage of them have tried a TIP clause at least once and been successful. We get lots of e-mails from firms who have done it. We know it's out there, I just don't know how prevalent.

Q*: *Does this concept exist in other professional service firms? Lawyers were the innovators of it. They have always had a more expansive view of pricing. Lawyers are not as attached to the billable hour as the CPA profession because lawyers have other ways to price through various fees and contingencies. IT firms and advertising agencies are beginning to do this too.

Q: Are there any downsides to the concept? The downside is if you don't add value and the client doesn't pay you, or doesn't pay you enough to cover the cost of your resources, but the downside is very, very small. We've only seen the downside when firms try to get the TIP during or after the work instead of talking to their clients up front. ■

Ron Baker is the founder of the VeraSage Institute, a think tank dedicated to eliminating the billable hour and timesheet from professional knowledge firms. Contact Ron at ron@verasage.com *or reach him at (707) 769-0965.*

Visit www.verasage.com to download "Burying the Billable Hour," "Trashing the Timesheet," and "You Are Your Customer List."

INSIDE PUBLIC ACCOUNTING is published monthly by *The Platt Consulting Group.*

INSIDE PUBLIC ACCOUNTING (ISSN 0897-3482) is the profession's authoritative independent newsletter for reporting and analyzing news, trends, strategies and politics in the accounting profession and is publishing by The Platt Consulting Group.

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