Produced by
Business Fitness

The Good, the Bad & the Ugly of the Australian Accounting Profession

2018

Good Bad Ugly

EXECUTIVE SUMMARY

Benchmarking Report & Practice Improvement Guide for Australian Accounting Firms

The Human Behaviour Lag

We've spent previous editions of the Good Bad Ugly urging accountants to be swifter and more determined in the shift to a digital business world.

Indeed, at Business Fitness, we've spent the better part of 20 years speaking about the need for firms to constantly stay abreast of technological trends and opportunities. Now, in 2018, I believe the industry has matured enough for us to take a moment to pause, and reflect on just how far we've come.

As far as technology goes, you'd be hard-pressed to find a firm that hasn't progressed in the core areas of technology. Many have completely revolutionised the way they manage their firm and workflows, begun diversifying their services, and shifted their core philosophy to place a premium on client relationships and communication.

Despite all the traditional misgivings about accountants being resistant to change, I believe our industry is embracing technology and process change for the betterment of both firm and client.

What we are seeing at Business Fitness is steady adoption of innovative tools—yet firms are struggling to capitalise on the benefits of the powerful new technology at their fingertips, primarily due to what we are now calling the human behaviour lag.

This lag is typically caused by a combination of factors within a firm, some of which can be summarised as:

- No investment in training and awareness in how to fully utilise new technology;
- Absence of appropriate reviews as to the suitability of existing processes to work in harmony with the new technology; and
- Negative mindset towards the urgency for change at all levels in the firm.

Many firms believe that simply implementing new technology is sufficient to optimise efficiency in a digital environment, and still fail to derive the benefits. We believe this explains the results of this year's Good Bad Ugly technology poll, which concluded that the #1 technology-related challenge for Australian accounting firms is to fully utilise existing systems.

Among firms that have invested heavily in technology over the last 2-3 years, only a small minority of them are fully utilising these tools (tools which, if applied correctly, could drastically reduce the costs of compliance and improve client service), we at Business Fitness are questioning whether Australian firms are really seeing an ROI from this "investment".

It seems, after years of pushing for technological change, it is human change that poses the biggest barrier.

However, concluding on a note of optimism, 91% of accountants believe 2019 will be either the same or better than 2018. This is a drastic change in a single year, and a significant improvement from the 1 in 4 accountants in 2017 who prophesised that 2018 would be worse than previous years.

If the accounting industry has proven anything, it's that it will continue to embrace challenges and trends as opportunities to better serve clients and lead their firms.

Welcome to the 2018 edition of *The Good, the Bad the Ugly of the Australian Accounting Profession.*

Stuart A Spalding, CA

CEO, Business Fitness

Team profile of a typical Australian accounting firm

NUMBER OF PARTNERS
2

FTE TEAM MEMBERS
13.4

LEVERAGE
5.0

NUMBER OF CHARGEABLE FTEs
7.9

NUMBER OF NON-CHARGEABLE FTEs
3.0

AVERAGE SALARY
$72,030

Client profile of a typical Australian accounting firm

Average client group fee
$3,913

Clients per partner
226

Client

Average client fee won
$2,758

Average client fee lost
$2,810

Profile of a typical Australian accounting firm (based on median results)

The average Australian accounting firm profile

Revenue

Revenue	Expenses
$2,171,313	$1,572,817

Net profit (aps $200k)
$286,253

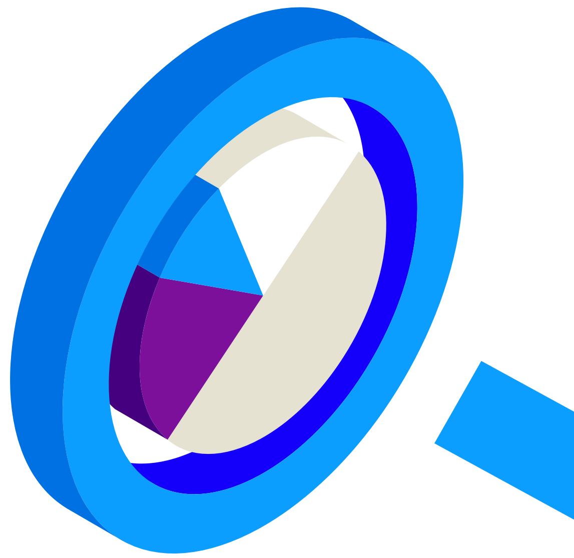
Partner return on effort
$183/hr

Net profit (bps)
$731,697

Cash flow of a typical Australian accounting firm

WIP – 24 DAYS*	DEBTORS – 53 DAYS

**19.7% of firms do not charge time to WIP*



Overview

Partner revenue plunges

The Good Bad Ugly team at Business Fitness have had to review the data a number of times to validate this year's results. Revenue per partner has dropped a whopping 17% to $935k, which is a withdrawal back to 2015 levels.

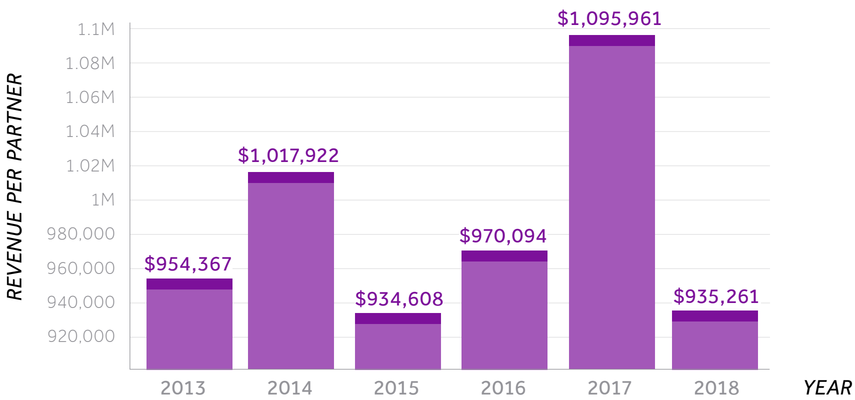
Like you, we were curious to understand why partner revenue has decreased so dramatically. Was the data sample size skewed to smaller firms in this year's survey? On a first review, the participating numbers were similar to the 2017 survey across all revenue groups.

But on further analysis, results show that firms who did not participate last year were placed at the lower end of the cohort as compared to the upper end of the group. (Particularly for firms greater than $1.5m in revenue) Consequently, when you review the 'Revenue Group Summary' section in this report, you will see the range for a number of the revenue groups has fallen.

In summary, median firm revenue fell by 4% and revenue per partner fell across all revenue groups. One possible reason for this could be firms introducing new partners to the firm as part of succession planning.

Interestingly, the graph below shows a similar trend of declining revenue per partner in 2015.

Somewhat concerning is those returning participants also experienced a fall in revenue per partner, registering a 2% decline. The million-dollar revenue per partner mark still seems to be a hurdle for many firms and partners.



Profit also declines on the back of revenue

With a decline in overall revenue per partner numbers as discussed above, this also has an impact on profitability but to a lesser extent with Partner profitability falling to $327k. (Before partner salaries) This is down 10% from the 2017 level of $362k.

The data reveals that Net Profit % before partner's salaries hasn't changed at 35.7%. When you apply a notional $200k salary per partner, exactly one in four partners make a loss. Firm profitability remains approximately 13% after the notional $200k partner's salary being applied.

What was encouraging was those returning firms recorded a 4.5% profit per partner increase despite the 2% fall in revenue.

Declining leverage

One of the key measures that has a direct correlation to high firm profitability is leverage. Highly profitable firms have high leverage (people to partner ratio). Again as mentioned above, we can see that the leverage numbers across all revenue groups have declined which is a direct cause of declining revenue and profitability.

Is this the biggest challenge facing accounting firms in 2019, finding quality staff? Our Business Fitness account managers have recently reported many firms are struggling to find both accountants and administration staff. In addition to this, firms are also mentioning they currently employ long term inefficient staff who are experiencing the 'behaviour lag' as mentioned in the foreword to this report. There may be more efficient staff who can complete work at a more efficient pace at less cost, but finding them right now is difficult.

Leverage has fallen across all revenue groups and by as much as 1 person per partner. This is significant if you consider the average chargeable team member is generating approximately $200k in fees.

Also, with the introduction of technology automating a significant amount of administration work, is this affecting firm team structures? This should show in a larger ratio of chargeable team members to administration staff. The results show no significant increase in this ratio with approximately 4 chargeable staff to one non-chargeable. Could this be 'behaviour lag'?

Cash flow is a winner

One area that continues to improve in recent years is cash flow. Lock up (Work-in-progress and debtors) is again at its lowest levels in 17 years at 74 days. This is in stark contrast to 10 years ago when lockup was recorded at 94 days in the 2009 Good Bad Ugly report.

Reducing your costs

As a percentage of revenue, expenses remain at 63% for the 2018 year. Small increases were seen in rent, outsourcing expenses and online subscriptions. Interestingly, there was a reduction in chargeable staff salaries compared to an increase in administration salaries.

Are partners working harder for less reward?

We receive a number of questions about our Partner return on effort metric. This is a simple measure of profit per partner by the total number of hours worked to generate this profit. With approximately 19% of modern firms not recording time and pricing on value, this does have a minor impact on the final results.

This year with the fall in profitability levels due to small firm participation, you can conclude that smaller firms are working harder for less return with the partner return on effort falling to $183 per hour. When you analyse the raw data it is showing that partners worked a day less than in 2017.

Understanding the type of practice you have?

In previous editions of the Good Bad Ugly Report, Dr Greg Timbrell has challenged your thinking about the type of practice you have. Based on David Maister's classic, Managing the Professional Service firm, Dr Timbrell suggests the work that you do dictates the structure of your practice, the type of people you employee and how much money you make.

Essentially, Maister described professional services firms as sitting in a spectrum of Efficiency-Experience-Expertise. Anna Curzon in her keynote at the recent 2018 XeroCon in Brisbane, modernised it specifically for accountants as: Compliance-Simple Advisory-Complex Advisory.

So as you read this year's Good Bad Ugly report, understand what type of practice you currently have and take that into consideration when comparing your firm to others. In our Good Bad Ugly surveys, we found that partners spend approximately one-third of their time managing each of the three areas. But when it comes to resourcing, structure and billing, approximately 55% was efficiency and just 17% expertise services. This is reflected in this year's survey showing compliance fees remain at 61% of fees generated.

So, if your results are below where you expect, we invite you to use the 2018 Good Bad Ugly report as motivation to create change. High performing firms view this as an opportunity. All firms, regardless of performance must review results and consider strategies to consistently perform at the peak of their game. Understanding what type of practice you have is a critical component to this. The 13 articles written by industry specialists will help identify your goals and provide strategies for action.

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