practiceresources

Capturing out-of-scope work

Is your firm doing extra client work for nothing?

By Lee Eisenstaedt and Tom Siders

CPAs often face the dilemma of how to bill for work they do outside the scope of the engagement letter. This work can cost firms as much as 20 percent of their billings.

Evidence from our 2012 annual survey of accounting firm leaders shows that this age-old problem is still relevant. More than 80 percent of respondents told us that they need to get better at identifying, billing and collecting for out-of-scope work. So it's worth taking a look at how firms can recapture some of the lost billing.

COMMON CAUSES OF OOSW

Before discussing solutions, we need to establish how OOSW is created. The most common reasons we see (in no particular order) are:

- Poorly written engagement letters that fail to correctly outline the work to be done; omit a provision for the extra costs involved when the client doesn't perform as expected; and don't include a process for handling changes in scope.
- Fear of losing the business by telling the client there will be extra cost for additional work.
- Erroneously thinking that not billing for OOSW is a way of providing great client service and gaining client loyalty.
- Underestimating cost. Using a best-case scenario to budget an engagement is unrealistic; it is far better to base your quote on historical facts and figures or, in the case of a new client, on the basis of your experience with similar clients.
- The most common cause for OOSW may simply be a lack of discipline in updating actual versus budget during the engagement.

CONSEQUENCES

The consequences of not billing for OOSW are compelling. First, financially, not collecting the fees you are rightfully owed leads to lower realization, profit margins and profitability. Second, it can lead to the market perception that the firm has cheap pricing; to clients becoming trained to expect that they will get something for nothing (or, worse, not even realizing they are getting something for nothing); and to diminished employee morale.

A certain amount of OOSW is unavoidable. In fact, it may even lead to increased client satisfaction with the final product or to another engagement. However, with the stakes so high and growth so hard to achieve, avoiding scope creep — or getting paid for it when it happens — is crucial.

CAPTURING FEES FOR OOSW

Here are 10 of the best ways we've seen to do this:

1. Make sure you understand the details of the assignment and that your engagement letters reflect your understanding of:

- What you will do for the client;
- What they must do for you, including due dates for work papers and other documentation;
- What is excluded from the project; and,
- How much additional work outside of the scope will cost. Include a chart with the specifics so no one is surprised later on.

2. Create a project plan with a detailed budget — and follow it! You should include realistic milestones and key deliverables for each stage of the project; set priorities; and establish what is "nice" to do and what "needs" to be done in the event an adjustment is necessary after the work has begun. Then share the plan with the client, and continually monitor progress against it to avoid surprises.

3. Involve your staff in the process. Get their input on the project plan, and let them know how much billable time the project is expected to take. Make sure to teach them the difference between OOSW and cross-selling services, and that you talk to them about the importance of tracking OOSW.

4. Begin with the most difficult sections of the engagement first to avoid dealing with them during the wrap of the engagement, which can add unexpected time to the project and put timely completion at risk.

5. Record time daily to be able to effectively manage the project. (This doesn't have to mean the same day. One firm we know requires that each day's time be input by the close of the next business day.)

6. Avoid comingling in-scope and out-of-scope work by using different client/project codes for each. This may seem cumbersome, but it yields important information at the end of the project.

7. Create a formal change order process that is shared with both your staff and your client. Ideally, OOSW should only begin after the client has approved it and both parties are fully aware of what it means relative to the costs to be incurred, tradeoffs, and the impact on delivery of the final product.

8. Measure staff performance at capturing and recording OOSW. OOSW occurs on nearly all projects and accurately recording it is the first step to getting paid. Determining whether the time is billed to the client is a very different decision.

9. Bill OOSW on a separate invoice, so clients understand what they are being billed for.

10. Communicate early and regularly with the client on the status of the engagement. Good communication can't be stressed enough. We know a firm whose high write-offs and write-downs are due to its "delay and pray" approach: It "delays" telling clients about OOSW, "praying" that another part of the engagement will come in below plan to offset the overages.

You won't be able to recoup all of the costs related to OOSW. There are some circumstances where it is better to write off the OOSW in favor of a more lucrative engagement. Still, having a process in place for establishing with the client what is considered OOSW and tracking the time internally puts your firm in a better position to recapture some of the costs. AT

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