

Level 5 Service: Decision Support for Your Clients



The Knowledge Your Clients Want You To Have

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In the past, small to medium sized enterprises (SMEs) were largely managed based on lagging information. Relying heavily on historical financial statements that were months or weeks old, owners and managers were left with the task of trying to manage their future with a limited or delayed view of the company's performance. But that's not good enough anymore. In today's fast-paced business environment, decision makers need real time access to accurate and relevant performance feedback to stay competitive. Level 5 Service, provided by CPAs, provides business owners and managers the business intelligence they need to compete in a global economy.

The concept of decision support information systems is not new. Since the introduction of the IBM 650 in 1954, large companies have been working hard to capture and harvest mission critical information to better manage their performance. Although those behemoth machines were slow and cumbersome to use, they held great promise for real-time performance measurement and reporting. After 50 years, we're finally able to realize that promise. Advancements in information technology make it easier for even the smallest companies to level the playing field between themselves and their larger competitors. Unfortunately, many small and medium sized companies are not taking full advantage of the information resources available to them. They are not alone.

We can all relate to underutilized technology. Most of us learn only the aspects of the software for which we have an immediate need, often leaving behind many features and benefits of the program. Many times, we don't know what we don't know. Likewise, many business owners and managers are underutilizing one of their greatest assets, information technology.

It doesn't have to be that way. In recent years the lines between accounting and information technology have blurred. Many CFOs

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and Controllers now wear two hats; Chief Financial Officer and Chief Information Officer. Whereas accounting used to be considered a “back office” function, today’s CPAs are at the forefront of capturing, managing, and reporting on a company’s performance. They have an expanded role that includes helping companies make the connection between day-to-day activities and financial outcomes. CPAs are the ones who build the bridge between leading and lagging information. It makes sense that the same skills that make for a great accountant can be applied toward “accounting for” and measuring all aspects of performance, especially given the increasingly fuzzy boundaries between financial and other information sources.

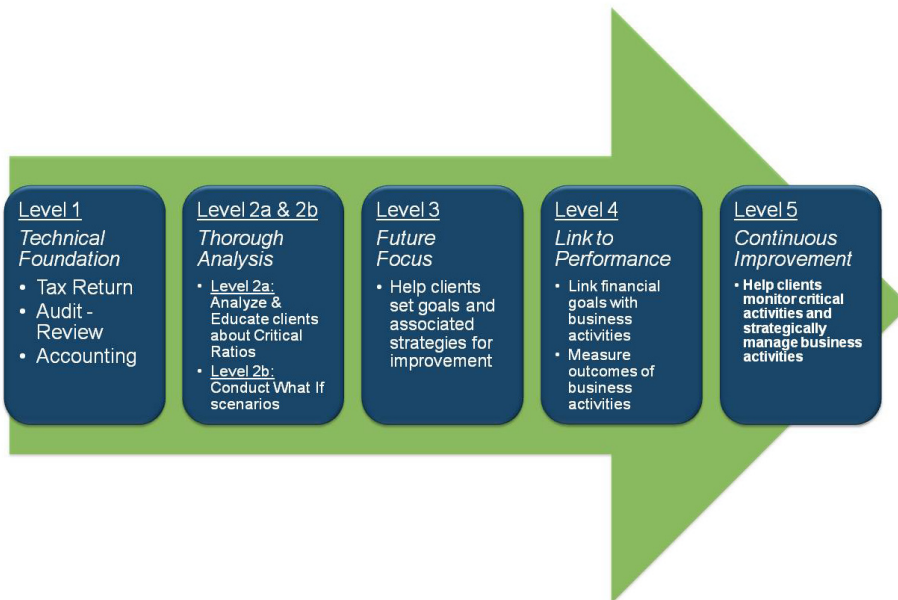
CPAs have the added benefit of being exposed to literally hundreds of different industries and business models. They see daily examples of what it takes for a business to be successful. In many cases, having the best product or service isn’t a guarantee of success. Those companies that can be nimble and adapt to a changing market or economic climate are more likely to be the winners.

Bottom line: the higher the quality of information, the better the decision making, which leads to better outcomes.

On one end of the spectrum are companies that use a fraction of their information systems’ capabilities. On the other end are companies that are data rich and information poor. Company information systems are spitting out so much data, that decision makers can be easily overwhelmed—they are drowning in too much data.

The Mentor Plus®

Level 5 Service Continuum



When business owners are asked about what they look for in a CPA, the subject of GAAP or accuracy seldom comes up; these are assumed competencies.

Time for a Change

It has been ten years since the AICPA Vision project identified the changing role of CPAs. The project identified the profession's need to make sense of an increasingly complex array of information sources to improve the quality of information for decision makers. The question is, how many firms have actually re-tooled their professional staff to address this required competency? And what is the missed opportunity for firms that have not?

Level 5 Service is a defined service continuum that addresses the desired Vision competencies. CPAs that deliver Level 5 Service help their clients leverage information resources, develop new performance measures tied to the goals and strategies of the organization and organize those measures into a cohesive reporting system. The ideal performance reporting system has the flexibility



to provide valuable decision support for owners and managers while also providing real-time line of sight feedback for all levels of employees. The traditional role of the CPA plus their objectivity and independence puts them in the unique position of seeing the company from a very balanced, big picture and detailed perspective.

Level 1

How have we done?

Level 2

What information should we be looking at?

Level 3

Where are we going?

Level 4

What will it take to get there?

Level 5

Are we on track and what is our next move?

Level 5 Service

So what is "Level 5 Service?" It encompasses what we think of when we hear the term "trusted advisor" for firms who are able to live up to that moniker. It provides a tangible definition of what it means to really add value to a client's business. Level 5 service goes beyond our current perceptions of a traditional CPA, the Mind Set, Skill Set, and Tool Set required for the next generation of CPAs to be successful. The process includes a step-by-step linear progression of service offerings and corresponding value for firms to adopt. Additionally, it is a service approach that helps accounting firms attract and retain quality staff.

Level 5 Service is not just a new process for delivering accounting services. It is a philosophy that starts with the realization that accountants can provide a very accurate set of financial statements without providing the insight their clients seek. Even though the financial statements are accurate from a compliance standpoint, they are not serving the managerial needs of the company. When business owners are asked about what they look for in a CPA, the subject of GAAP or accuracy seldom comes up; these are assumed competencies. The majority of business owners say they want their CPA to help them be successful. We are not suggesting that the current model for financial statements be abandoned, however, their usefulness as a management tool is limited. The Level 5 Service approach is about augmenting financial statements with reports that provide feedback on performance at all levels of the company.

The Service Continuum

Level 1 answers the question, “How have we done?” It includes the preparation and delivery of financial statements, tax returns, and other compliance work. All firms can do this. Arguably, some may do it better than others but from the client’s perspective this level of service is a given. There is no question that Level 1 Service is the backbone of the profession. Yet, these services have also become a commodity in the eyes of the marketplace making it difficult for firms to differentiate themselves.

Level 2a answers the question, “What information should we monitor closely?” Level 2 analyzes financial statements and highlights critical ratios. In an effort to avoid becoming viewed as a commodity, many firms are already providing this level of service. Some firms offer industry benchmarks, definitions, and implications of the ratios that are most critical to their client’s business and industry. This is a good step in the right direction, but focused on the past.

Level 2b Service begins to ask “what if?” questions. “What if we could reduce your receivable days outstanding? How much cash would that free up? What if you continue to grow at the current pace? How will that impact your cash flow?” Moving from Level 2a to 2b is a subtle shift from analyzing the past to exploring the future.

Based on many conversations with leaders and practitioners in the profession, it seems pretty clear that the majority of firms never go beyond Level 2a. A few make it to Level 2b. Even fewer make it to Level 3 and beyond.

Level 3 Service is all about the future. It asks the question, “Where are we going?” The role of the practitioner at Level 3 is to help clients articulate their vision, mission, long-term goals and identify



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areas of company performance that have a significant impact on the achievement of company goals. If your firm is providing Level 3 Service, you already have a significant advantage over most other firms. From a marketing standpoint, this is huge.

One particular managing partner took this to heart. He set off to change the culture of his firm to be more future-focused with clients. For months he coached the team on how to ask future-focused questions. His approach had limited success. Philosophically everyone agreed with his idea but the comfort of the status quo trumped the risk of changing to a new philosophy. The managing partner took a stand. He decided that focusing on the future was not an optional service, but a standard to which everyone in the firm must adhere. To ensure compliance, he added a new line item to all pre-engagement checklists. Before any engagement could be completed, staff and partners had to confirm that they had asked for and reviewed the company’s strategic plan. The simple question, “May I see your strategic plan?” was just the first domino to fall in a long line of advisory service opportunities. Clients became curious as to why these accountants were asking this question. Team members would respond with something along these lines, “It’s important for us to know where you are heading so we can 1) help you with tax planning and 2) provide you with information that is relevant to your goals.”

When asked for their strategic plan, a small percentage had one to share. This led to discussions about how and if the client was on target in achieving its goals, which often led to a discussion about setting up performance measures and a dashboard to monitor their progress toward their goals. A larger percentage of clients, as you would expect, did not have a strategic plan. This stimulated a lot of planning work; some informal, some very formal, including facilitated company retreats and board meetings.

In all cases, the firm gained a better understanding of what their clients wanted to achieve in their business. It changed the tone of all future conversations from focusing on what had already occurred, to how those occurrences would impact the future of the company and what, if anything should be done about it.

An interesting side benefit of this approach was that the accounting staff started asking to see the firm's strategic plan. At the end of the day, this effort raised the Strategic IQ of both the accounting firm and its clients. A great outcome resulted from adding one simple question to the firm's engagement delivery protocol. That is a simple but effective way to stimulate a Level 3 culture and service opportunities.

Level 4 is the next logical step after Level 3. If Level 3 answers, "Where are we going?" Level 4 answers, "How are we going to get there?" Level 4 is all about making connections between behaviors and outcomes. It involves drilling down from company-wide goals to those activities that have the greatest impact. This creates line of sight ownership and accountability so every employee can be part of the company's success.

Level 4 addresses the FASB's Qualitative Characteristics for financial disclosures. To better describe the connection between these qualitative characteristics and Level 4 Service we need to extend the definition of each.

Timely Information: The term "timely" is subjective. What is timely to one person may be late to another. The Level 4 definition of timely is real-time. Delivering a historical recap of the previous month's financial outcomes does not measure up to true Level 4 Service. We must establish the link between the goals of the company and the activities that will have the greatest impact on them and develop a reporting system that monitors those critical activities as they are happening.

Level 4 addresses the FASB's Qualitative Characteristics for financial disclosures.

FASB Qualitative Characteristics:

- Timely information
 - Accurate
 - Relevant
- Understandable



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For some companies with more sophisticated enterprise -wide information systems, performance feedback may be available down to the minute.

In the small business arena, real-time can mean everything from a daily log of activity posted on the lunchroom bulletin board to a weekly spreadsheet flash report. The idea behind real-time reporting is to allow owners and managers the opportunity to address issues before they become serious problems. How painful is it for business owners to find out their margins are slipping six weeks after the trend began? Or that their company is experiencing a significant increase in rework only after reviewing cost of labor and goods on a 30-day old financial statement?

There are a number of available performance measurement reporting solutions ranging from very low-tech to multi-million dollar information systems. Using these tools, Level 4 Service can be provided to any and all companies regardless of size, industry or type of business.

Accurate: Of course, everyone expects accuracy. To really meet the test of Level 4 Service however, the information must also provide a complete picture of the true performance of the company. The ongoing shake-up of the accounting profession serves as a painful reminder of the difference between meeting GAAP standards and applying a principles-based reporting criteria. The new EBR—Enhanced Business Reporting model has been designed around both accuracy and transparency. The Enhanced Business Reporting model is also driving the development of standardized non-financial performance metrics across all sectors.

Relevant: Information must link to something; it must be understood within a greater context. When it's relevant, information can lead to insight that leads to better management decisions. In many cases, relevance can be achieved through a restructuring of a client's chart of accounts to reflect specific performance areas of the company. Ideally, the information serves as a predictive indicator of progress in executing specific strategies tied to the overall goals of the company.

Understandable: Again this can be very subjective. What is understandable to the CFO may be a foreign language to a line supervisor. Ideally, the information should be organized and conveyed so as to provide feedback to all levels of an organization. To tell a supervisor that the company needs to be more profitable is not very useful. Compare that to telling the supervisor how his/her unit can impact the profitability of the company including the specific activities in which the department is engaged. Tell that same supervisor to sell one more case of your most profitable item per week. It may also include breaking the activities down to a task level so everyone, even the janitor, has a clear line of sight and personal connection to the company's profitability and acts accordingly.

The Level 4 Service approach creates an environment of continuous improvement where employees understand and respond appropriately to performance feedback. Continuous Improvement, or what the Japanese call Kaizen, also characterizes the ideal learning organization. At the heart of a kaizen culture is financial fluency. The Profit Equationsm is a financial fluency formula CPAs can use to educate clients about how to make the connection between activities and outcomes. The Profit Equationsm identifies the real drivers of profit. In its most simplistic form, the formula for measuring profit is

$$\text{Revenue} - \text{Expenses} = \text{Profit}$$

Enhanced Business Reporting

Enhanced Business Reporting (EBR) improves the quality and transparency of information companies provide so investors and other key stakeholders can make better informed decisions. With EBR, the focus is on shifting the model from one that is based primarily on historical or lagging financial information to a model that incorporates relevant value drivers, financial and non-financial performance measures, and qualitative information around management's strategy, plans, opportunities and risks. EBR delivers a broader view of current performance and a greater understanding of an entity's future. Coupled with enabling technologies like XBRL, EBR will provide users the breadth of information they require at the speed they need to be successful in today's economy.

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We not only want to measure profit, we want to improve it. To do that we need to look deeper into the activities that generate revenue and drive expenses. The formula to do this is

People X Process = Profit

This formula captures many factors that result in a particular outcome. The formula tells us what has happened and may serve as an indication of a future trend, but it does not identify the specific strategies that may need adjustment or improvement. It's a bit like going to the doctor and having them diagnose an ailment (which you probably already knew you had) and then sending you home without a treatment plan for improving your condition.

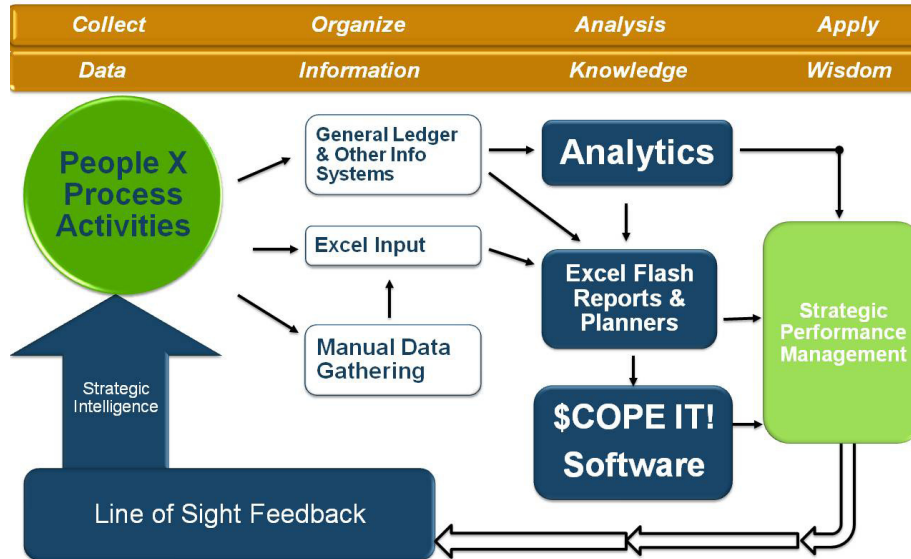
To bridge the gap between what has happened to providing guidance for the future, we must have a different, more balanced, perspective. That perspective is what we refer to as The Profit Equationsm; the true formula for business success. The formula behind the Profit Equationsm highlights the absolute need for a balanced perspective. It says we not only want to measure profit, we want to improve it. To do that we need to look deeper into the activities that generate revenue and drive expenses. The formula to do this is

People X Process = Profit

The activities we are referring to generally do not show up on the financial statements. If all of our focus is on financial indicators we end up with a lop-sided view of the business. By acknowledging that revenue and expenses are a function of people's behavior as they operate within a company's processes, we gain a much more balanced perspective that connects both leading and lagging performance indicators.

Level 5 answers the question, "What are we going to do next?" Level 5 is about acting on the information gleaned from Level 4 performance measurement systems. Up to this point, clients have sorted through all the available data housed in their company. They have zeroed in on a handful of measures that are most critical to the achievement of their goals. Now it's time to shift their energy from building a performance measurement system to strategically managing the performance of the company.

Level 5 Strategic Performance Management



In the diagram above, the left hand side of the spectrum shows people engaged in processes. That effort is defined as activities. Those activities produce outcomes that have the potential to be measured. Some of the activities are more relevant to the goals of the company and get organized into a number of information receptacles, such as the general ledger, a point of sale system, project management and estimating programs, plus many others (including some that may be industry specific.)

From there the information is analyzed and reviewed within the context of a company’s goals. Insight is gained from this analysis providing decision support for owners and managers. To close the continuous improvement loop, line of sight feedback is provided to employees. When employees are informed about company goals and strategies and, most importantly, understand how their actions impact those goals, they are far more likely to act with strategic intelligence.

Lopsided Coaching

John Madden, famous Oakland Raider football coach and well known commentator spoke once about the influence of technology on the “game” of coaching. He told the story of the early years of coaching where performance of the team and individuals was captured by pencil and paper. As technology became more prevalent, the performance aspect of every play of every game was captured and analyzed. John went on to say that the “pencil and paper” approach resulted in an unbalanced focus on the offensive side of the game. It wasn’t until technology made the process easier and more comprehensive that they realized how their lack of focus on defensive statistics resulted in a very lopsided approach to coaching. The same could be said of accountants who only focus on financial outcomes.



“The Rule of Seven provides the motivation to expand client relationships.”

A new level of trust

A Level 5 Service provider is the epitome of a “trusted advisor.” You know you have reached Level 5 status when your clients call you first when they have important issues to discuss. You meet with them regularly to review and revise the measures being monitored. As the issues and priorities of the company change, they look to you to help them develop new strategies and the associated measures. Ideally, those measures point out where the company needs to improve so any issues can be addressed in a timely manner.

Equally important, the measures should provide feedback about where the company is performing well so performance can be recognized and repeated. Currently, many companies are moving to performance-based compensation programs. In order for them to effectively implement such an approach they must be supported by Level 5 quality of information.

Level 5 Service has the potential to move the profession from a compliance-oriented relationship to one based on reliance. Remember, the majority of firms are not providing Level 5 Service. That opens the door for firms that do.

Level 5 Service provides high quality information and guides clients to act strategically on that information. Without having to cross the line of independence, CPAs can facilitate a much higher level of decision support than financial statements alone could ever achieve. Software, such as Mentor Plus® \$COPE IT! Software can help firms make the transition to Level 5 Service even easier. Beginning with Level 1 information, the software addresses each subsequent Level culminating in the development of Level 5 management reports. This is called leverage. Whenever there is an opportunity for a little effort to produce a big result, it’s a no-brainer. Given how easy it is to get

from Level 1 to 5 and the positive impact it has on client relations, firms that are not taking advantage of this should carefully examine their priorities. This is especially true when you consider that the cost of acquiring a new client is 7-10 times more than the cost of expanding a current relationship.

If every firm in the country operated at Level 5 Service, one would expect to see an increase in the retention of ideal clients and key staff. Correspondingly, firms would experience higher realization rates serving fewer clients. Likewise if every company was managed with Level 5 quality of information we would have a much stronger economy in the long run. If that isn't motivation enough, consider The Rule of Seven. The "rule" comes from the insurance industry. It was determined that an average American has 7.2 insurance policies. If a broker only had one line of insurance with a given client there was an 80% chance that the client would switch brokers in the first two years. If the broker had three to four policies with an individual, the attrition rate dropped to 60%. If the broker had four or more policies, attrition dropped to less than 20%. Lesson: the more insurance products a broker provided to a customer the higher their retention rate. The corollary for the accounting profession is equally telling. If a firm is only delivering Level 1 Service it is vulnerable. By expanding the relationship to Level 5, the firm would see an increase in loyalty and the perceived value of the overall relationship.

Reaching Level 5 Service should not only be viewed as an expansion of services, but also a fortification of traditional services; the backbone of the profession. To maintain current revenues generated from Level 1, compliance type services firms must expand client relationships to include more value added service offerings.

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Getting started

If you want to expand your accounting firm, expand what you are accounting for. There is a huge opportunity for the profession to help clients account for all types of activities in their organization, not just financial outcomes. The good news is that the market is already asking for this additional support.

What will it take for you and your firm to become a Level 5 Service provider? What does it take for your firm culture to be oriented toward Level 5 Service? Certainly you need to commit time and resources to gain the Level 5 Mind Set, Skill Set, and Tool Set. It doesn't happen overnight and only those firms that are committed to a long term cultural shift that takes place over a two-year period are likely to see the greatest return on their investment.

Before you start adding up the cost of re-tooling your team and restructuring your deliverables, you need to look at what it is costing you in lost opportunities every-day that your firm is not providing Level 5 Service. For example, what are the lost opportunities with prospects who you were unable to convince that your firm was "really different" from others? Or add up the lost opportunity cost of clients who spend 5-10 times your annual fees on consultants to help them do what you could be doing for them? Or add up the cost of losing your firm's best talent for lack of interesting work for them to do. This is just the beginning. It doesn't take long to see that the benefits far outweigh the investment.

There has never been a better time to re-define what it means to be an accountant. CPAs are at the forefront of information management. The demand for decision support is growing exponentially every year. By developing a Level 5 culture in your firm and delivering Level 5 Services to your clients you will have achieved a true win-win for everyone concerned.

About Mentor Plus

Mentor Plus, a leader in training and consulting to the accounting profession since 1997, is dedicated to helping firms make the transition from a “service centric” to a “client centric” culture. Through their programs, accountants learn the art of understanding and the science of exceeding clients’ needs.

About the author

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