



PRACTICE BUILDER

Succession Planning for Tax and Accounting Practices

By Joel Sinkin

AS TAX AND ACCOUNTING PROFESSIONALS, WE ADVISE and help our clients plan years before they retire or sell their businesses. Yet so many of us fail to take our own advice and wait too long to start the process of succession planning.

When do you start?

Many practitioners believe they either own their practice and work it full time or sell it. There are many interim steps available for most firms if the owner so selects. Many professionals desire to gradually reduce their time commitment to the practice and ultimately sell, but they may not desire to walk away completely. The first thing a practitioner must do is envision how many more years, or tax seasons, they desire to work full time. Most practices have a significant number of personal and business clients they only deal with annually. Some clients may have contact with the office or staff throughout the year but are truly only seen in person once by the owner.

If you are five years from seeking to reduce your role, that may seem like an eternity to you, but in reality, it is only *five* visits for many clients. To understand the impor-

ance of this, let us remember why we have the clients we have. In most cases, if they were able to complete the work we do for them, they would not have hired us. We have the clients we do because, in most cases, the clients like and trust us! Yes, fees, location, service procedures, etc., are critical as well. With that said, if the client was not comfortable with you, eventually, the client would choose another firm.

The key to any deal working for everyone is client retention. This is why the process of succession planning is started by reviewing how much longer the owner(s) desires to have contact with the clients. Affiliating with the ultimate successor well enough in advance to give the clients an opportunity to gain a comfort level with them is ideal. There are methods of affiliating that enable the retirement-minded members of a firm to maintain control and income while gradually

getting their clients and successor acclimated to each other.

Your practice has its greatest value when it is running at top efficiency. By creating your succession plan in advance when the practice is at its peak, you can structure the most lucrative deal. There are other variables that can affect the timing of when to start a succession plan. If you are about to make a major investment into technology, relocating, staff, and other such items, this may be the time to review your succession plan. Perhaps there is a firm or individual you can affiliate with that will either participate in this investment or by affiliating with them now, you may satisfy your need. For example, if you needed additional staff capacity or technology and were thinking of reducing your role in the next five years or so, why not affiliate now with a firm that has the technology or excess capacity and accomplish multiple goals simultaneously?

How can I structure a deal whereby I retain income and control and create a succession plan at the same time?

There are several ways by which a practitioner may affiliate with their ultimate successor without becoming a junior partner in their own firm. When you have been the head honcho for many years, you do not want to become someone else's clock-punching employee. In many deals, a structure can be created whereby the retirement-minded practitioner can become an infrastructure

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ILLUSTRATION BY SETH SIRBAUGH

within an infrastructure. This is most effective when the two firms share space as well, but it is not mandatory.

For example, if I have a firm doing \$200,000 in annual revenues and I net \$90,000, and I desire to reduce my role over the subsequent five years, I may do something as follows:

- Affiliate with a firm and share space: mine, theirs, or a new space (as mentioned earlier, it is not mandatory to share space but simply preferable on many levels especially from a back up, support, and transition of clients perspective).

- If I were devoting 2,000 hours to my practice of which 70% was billable and I continue to do the same, why should I not make the same money? I can still come and go as I see fit, yet have back up, support, and gradually get my clients and successor to know each other. This also acts as an insurance policy since if I have a short term health problem, my ultimate successor is

there to cover me. If I have a serious health issue or worse, my succession/buyout can be accelerated and my estate and clients are well protected.

- There also should be some overhead reductions that become available due to economic synergies that get created in rent, labor, software, and other overhead items when sharing space. There may even be niches that one firm has that the other did not, thus, creating new income potential through cross-selling these additional services.

- In the future, if I elect to reduce my time commitment to the practice, I would need to accept pro-rata reductions in my income.

- At the time I reduce my role below a certain predetermined level or on some back date perhaps, the buyout payments commence.

The above affiliation can take the form of a merger, a sale with a continuing employment/consulting agreement, or a practice

continuation agreement. There are several things to remember:

- 1) If you do not want to eat lunch with someone, they should not be your ultimate successor!

- 2) Never do a deal that leaves it open to work out terms in the future. Basically, agreeing to agree when you are ready to retire is bad news. Work out all your terms in advance.

- 3) Use common sense. Buyers do not acquire practices to lose money and the seller needs to be properly compensated for his or her years of sweat equity. Everyone can win when the deal is structured correctly.

This is not to say that a practitioner *has* to plan in advance. Over the years, I have received many a call from practitioners in the months of May and June telling me it was their last tax season. I am simply suggesting that planning in advance will help to maximize profits for the buyer and value to the seller.

I am in a multi-partner firm and we are seeking some advice on an internal succession plan

It is scary how many multi-partner firms do not have a strong internal succession plan; some may not even have a partnership agreement! Here are a couple of important items to review if you are in a multi-partner firm:

- Do my partners or managers we hope to promote have the excess capacity to replace me? Going back to the example stated previously, if a partner is working 2,000 hours and 70% is billable, do the professionals I expect to replace me have the excess capacity or ability to pass down enough work to ultimately replace what I do? If not, right off the bat you have a serious problem and may need to plan to bring in more talent to deepen your succession team or consider an external affiliation to accomplish the plan.
- Is it possible several of the partners may desire to retire or reduce their time commitment to the practice within a short period of time from each other? This obviously ties into the above bullet point.
- Is there a strategy for getting the clients who predominantly deal with the retirement-minded partner comfortable with a replacement?

Valuing the partner's equity interest in the firm is also an important item to both parties. Although this is not dealt with in great detail in this article, there are some basics that need to be considered. As discussed earlier, the buyer, in this case the remaining partners, should all make more money when a senior partner retires. If the other partners of the firm calculate they will lose money because the buyout payments to the seller are greater than the value they will receive, huge problems are ahead. In many cases, these junior partners leave the firm prior to being placed in this position, thus, destroying the entire foundation of the succession plan. In worse case scenarios, the successor firm could struggle to the point of default on the payments and everyone would lose.

Here is a basic concept almost too simple but is an excellent starting point nonethe-

less. When a partner is retiring, start with how much total compensation that partner currently withdraws from the practice including perks, benefits, profit sharing, etc. Next, calculate the additional cost of labor to replace that retiring partner. The following is an example:

A partner's total compensation package is \$150,000. When that partner retires, the firm will have to hire an accountant to pick up some of the work being passed down by junior partners at a total cost including taxes, benefits, etc., of \$70,000. Therefore, the firm expects to enjoy \$80,000 of additional profit. Now the negotiations have a starting point because the question should be what percentage of that \$80,000 should go to the retiring partner for his or her equity and what percentage should go to the remaining partners and for how long.

If you are a staff member of the firm and want to be considered for being part of the internal succession team, make your presence known. Develop new clients, join organizations for networking that help in

an advisor. It is important that the professional you work with has handled dozens, if not hundreds, of deals so they truly understand the alternative methods of handling the same items. If you do hire an advisor, know their fees and whom they represent (if you work with a broker, some represent the seller, some the buyer, others claim to represent both). Brokers charge fees from 3–10%. Most simply provide introductions, others assist in valuations, deal structure, and drafting and creating effective transition plans. The key is getting advice from a professional who has enough experience to provide you assistance throughout the process.

There are many items to consider when starting a succession plan: the worth of the practice, structure of the deal, how to handle accounts receivable, and others. How do you protect everyone in the documentation process? What should be the transition strategy to retain the clients and critical staff? Just as you advise your clients to come to you for your expertise in handling their tax and accounting needs, don't try and do

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client development, and ask for the opportunity. To be ultimately considered you will have to demonstrate the leadership skills of a partner; however, if you do not ask for the opportunity, people may not take note of the efforts you are making as readily.

Get Help

There is an old saying in the legal profession: a lawyer that represents himself has a fool for a client. Find a consultant, fellow practitioner, attorney, or broker who has specific experience relating to the accounting and tax field issues of mergers and acquisitions. Don't feel that a firm that has gone through a few deals is adequate to be

this yourself. Your practice can be one of your largest assets and it is a difficult and possibly emotional process. Many firms considering succession look upon the clients as friends, even family. It very well may be the last and most important decision you make regarding your practice. Seek the assistance of professionals who have significant experience relating specifically to accounting and tax practice sales. Our industry is unique and most deals are structured very differently than the deals done outside our profession. One of the keys though will be to make your plan in advance. When done correctly, this can be the ultimate win/win deal. **EA**