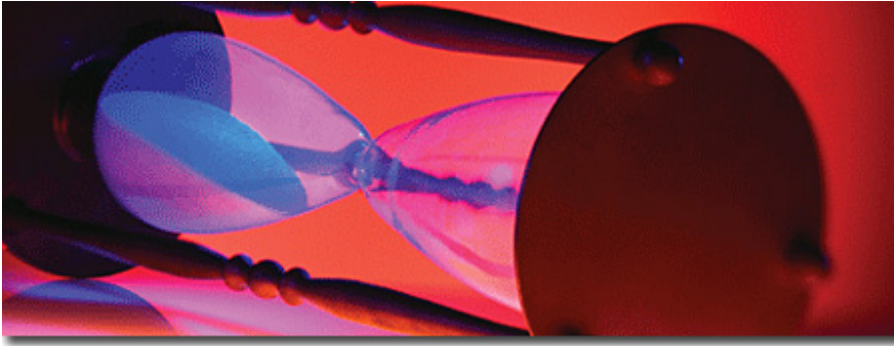


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Hourglass Effect

With labor shortages looming, internal succession planning couldn't have come at a better time.

By Joel Sinkin

IS YOUR PRACTICE READY FOR INTERNAL SUCCESSION? IF THE

answer is no, then consider this: The majority of today's Baby Boomer-dominated, multi-partner firms face the reality that one or more of their partners will retire or reduce their workloads over the next 10 years. At the same time, the supply of new, talented CPAs coming into public accounting isn't as plentiful as one might hope. Preparing for this eventuality through internal succession planning could mean the difference between life and death for many firms.

Your planning strategy The optimal time to plan for partner succession is when the firm is first established. No true partnership agreement is complete without language that handles this critical issue.

In determining the timeframe needed for the successful transition from retiring to successor partners, first evaluate the amount of face time the current partner devotes to each client. How often does he/she personally deal with his/her clients? If the partner in question is five years from retirement, but typically deals with clients annually, then in reality this represents only five more client visits.

There are other considerations, too, not least of which is client loyalty. Most clients hire an accountant because they lack the technical skills necessary to perform the work at hand. As such, they have no idea how to truly evaluate their practitioner's technical skills. Rather, the relationship is based on their like and trust of their accountant. For a succession plan to work well, there needs to be adequate time to transition this loyalty. The measure of a successful plan is in the number of clients that are retained.

Are you ready? There are three key points to consider when evaluating whether your firm is ready for succession. First, how much billable and non-billable time is the retiring partner currently devoting to the firm? Second, does this partner have a license or specialty that the remaining partners do not have? And third, does the firm have adequate time to conduct a proper—and smooth—transition?

Once you understand the amount of time the retiring partner devotes to the firm, you'll be able to

devise an appropriate plan to overcome his or her absence. For one, the firm can rearrange its current workload to allow the remaining partners to “pass down” specific areas of responsibility to staff. Or the firm can hire additional talent to pick up the extra work.

This also may be a viable option if the retiring partner has a niche, specialty or license that the remaining partners cannot offer. If this is the case, at some point in the future you may need to look externally to merge into or acquire a firm that possesses the time and skills your firm is lacking.

Lastly, you’ll need to look at your client base objectively in order to assess the level of service and attention each client typically requires. Many senior partners would have reduced their billable time prior to reducing their roles in the firm, but still do a lot of client “hand-holding.”

The key is to transition clients without them knowing it. In other words, instead of emphasizing the loss of a partner, focus on the gain of another professional to work on the client’s behalf. Bring in the partner’s ultimate replacement early on in the process. Emphasize this person’s level of skill and perhaps present them as having a degree of expertise in the client’s field that the original partner did not have. Gradually, the senior partner may reduce his or her time with the client as the succeeding partner picks up the slack.

Valuing partner equity A slew of variables need to be examined when tackling the issue of value. These variables include profitability, assets, client-base strength, treatment of accounts receivable, work in progress, capital accounts (if any), tax treatment of the buyout dollars, duration of the payout period and retention clauses, to name a few.

Many firms have lost their young partners because they feel that, as a result of the senior partners’ buyout agreements, they could take a serious financial hit when the partners retire. To guard against this, look at the total compensation a retiring partner is currently enjoying. This total package includes base salary, profit participation, perks and benefits—basically all the dollars they currently take out of the firm which, upon retiring, will become available to the firm. From this sum, subtract the total dollars, if any, it will cost to replace the partner. The difference is the amount of additional cash flow the firm should enjoy if all else maintains a status quo.

Now the negotiations can begin based on what percentage of this additional cash flow should be allotted to the retiring partner for his/her years of devotion to the firm, how much additional income the surviving partners will receive, and how long these buyout payments will last.

Many retirement-minded partners prefer to remain with the firm in a part-time role prior to complete retirement. When this is planned early, it can be a great help in securing a more successful transition. However, this may affect many other aspects of the succession plan. For example, the fact that the retiring partner is slowing down his or her work pace may mean that buyout payments will need to be deferred to allow them to receive compensation for their per diem work. Understanding the role of former partners and their compensation structure when staying on in a reduced capacity is a critical part of any succession plan.

The issues to take into consideration when devising a plan for internal succession are many. However, to ignore them will mean facing an even greater issue: Extinction. □

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