The 2012 PCPS Succession Survey, a joint project of the AICPA Private Companies Practice Section (PCPS) and Succession Institute LLC, found nearly 80% of CPA firm owners expect succession to become a major issue for their firms in the next 10 years (see “Succession Planning: The Challenge of What’s Next,” JofA, Jan. 2013, page 44).

The same study revealed, however, that more than half of all accounting firms—and more than two-thirds of those with 15 or fewer professionals—do not have a signed succession agreement in place. The percentage of firms with signed succession plans is on the rise, but it is behind where it should be with large numbers of Baby Boomer CPAs eyeing retirement over the next several years.

The trend is not surprising. In more than 20 years of consulting with thousands of accounting firms, the authors have found that CPAs often put off planning for retirement and succession. Two main reasons for this are:

- **Loss of income.** Transitioning a firm or book of business means selling in the minds of many practitioners. Selling means at least partial loss of current income. A practitioner who is three years away from slowing down often can’t justify giving up current income to accomplish what feels like a long-term goal.

- **Loss of control.** Most owners and partners believe they are the master of their domain. The idea of losing some control is so distasteful they prefer to ignore their succession plans.

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**About the Series**

Powerful forces are transforming the accounting profession in the United States. The Baby Boomers are heading into their retirement years. Baby Boomer CPAs are in charge of most U.S. accounting firms, and most U.S. accounting firms don’t have a signed succession plan or practice-continuation agreement in place.

These realities are rewriting the rules for U.S. accounting firms and CPA firm owners. Firms must contend with unprecedented financial, cultural, and marketplace changes.

The JofA is presenting a succession series designed to help accountants navigate the new landscape of succession and mergers. This month’s installment, the fourth in the series, looks at the two-stage deal—a form of CPA firm sale well-suited to succession situations.
A two-stage deal allows the selling practitioner to retain control of the practice and to maintain his or her income level during the transition.

Reducing their time commitment to the practice. In essence, the two-stage deal involves affiliating now with a successor firm, starting the transition while the practitioner is still in control of his or her practice, and postponing the adjustment in income until he or she slows down. At that point, the retiring/selling partner would start receiving payments for the sale of the practice.

The first stage of a two-stage deal lasts a maximum of six years and is particularly important for practices with partner-loyal clients. It usually takes two to five years to properly transition partner-loyal clients from the departing CPA to the successor, whereas brand-loyal clients typically take less time to transition.

**Example.** A sole proprietor was generating $500,000 in annual revenues with one full-time senior professional, a full-time paraprofessional, and a clerical person while netting 40%, including perks and benefits. This owner wanted to work three more years full time and several more years in a part-time role thereafter. The buyer was a three-partner firm generating $2.2 million a year working with the new firm to begin while the selling partner still controls his or her practice and maintains his or her income level.

Stage One was set up to be a maximum of three years. At its inception, the two practices were combined. Stage One could end sooner at the discretion of the selling, or transitioning, owner. The successor firm provided the practice with the same amount of labor required in the past through a combination of retaining and replacing staff, as both were deemed necessary by the parties. The successor firm took over most of the administration, and the deal was held out until the selling owner’s original clients as compensation. Stage One was set to terminate on the first of the following events: (1) the end of three years; (2) the death or disability of the transitioning owner; or (3) the election of the transitioning owner.

Stage Two was the buyout, and it was set up in a traditional fashion. Stage Two kicked in at the end of Stage One. By deferring the buyout until the full-time compensation ceased, the transitioning owner could extend the period for his full-time compensation, and the successor wasn’t being asked to pay for the practice and full-time compensation at the same time.

The authors have found buyers and sellers prefer this approach for several reasons:

- Transitioning owners are normally exposed 100% to the loss of any business. The loss of a $50,000 client means $50,000 less profit when they are on their own. In a two-stage deal, the successor firm...
is in a much better position to adjust costs and maintain margins. Under the above compensation formula, the transitioning owner’s compensation decreases by only 40% of the $50,000, instead of all of it.

If the transitioning owner suddenly needs more labor than he used in the past, he has the resources available. So if he wants to cut back his hours to, say, 80%, he can. His compensation would be adjusted for the use of more labor, but he has much more flexibility.

The transitioning owner can cut back her overall time due to a much lower administrative burden without giving up income, or she can redirect that time to practice development or more client services.

This structure operates like a practice-continuation agreement but with complete certainty of outcome.

Most two-stage buyouts include a retention period just as outright sales do. However, because Stage One is where the transition is primarily executed, client retention is maximized, resulting in maximum value for both parties.

Both parties can focus on cross-selling additional services and developing new clients during Stage One, leading to a better outcome for all.

The successor firm usually experiences increased profitability even during Stage One due to elimination of redundant costs such as excess labor, rent, software, etc. Plus the successor firm can offer an expanded service mix to more clients.

The authors have used this technique for larger multipartner firms as well. They find many firms with partners in up to three categories of transition: (1) partners seeking to work for many more years and grow professionally and financially; (2) partners seeking to slow down in five years or less; or (3) partners seeking an immediate transition to retirement or part-time work. With the two-stage deal, all three categories of partners can complete a merger with one successor firm—a merger that meets everyone’s needs, including those of the successor firm.

Both the retiring practitioner and the successor can benefit from retaining clients and developing additional services and new clients during the transition.

For partners in the first category, a traditional merger is probably appropriate. They would exchange the equity in their firm for equity in the combined firm. A two-stage deal would accomplish everyone’s goals for the second category of partners. The partners looking for a short-term transition would be best-served by a traditional buyout using terms negotiated as a part of the merger discussion.