



CPA FIRM SUCCESSION: SOLIDIFYING THE FUTURE

How to Select a Successor

Third in a series: Numerous factors demand consideration when a CPA firm is looking to replace a departing partner.

by Joel Sinkin and Terrence Putney, CPA

Selecting the successor for a retiring partner in an accounting firm can take on many forms. The decision can be made by an individual CPA or by the firm leadership. It can involve the transfer of clients, ownership, and/or responsibilities internally or the sale of ownership to an outside entity. Regardless of the scenario, a number of factors should be considered in evaluating potential successors for a retiring partner.

This article looks at several areas CPAs can assess in weighing whether an individual or a firm would be a good fit to

take over a partner's ownership stake and book of business. Later articles in this series will delve into the details of calcu-

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 agreement or practice-continuation plan 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 third in the series, looks at factors accounting firms should consider when selecting a successor to a retiring CPA.

lating whether internal succession is possible financially and which deal structures make the most sense for external sales. Regardless of whether the retiring CPA or the firm has the final say on who the successor will be, the following advice can be applied.

When assessing internal candidates, do the following:

- Look at their track records. How have they performed when promoted in the past? Have they picked up things quickly? What does the track record show about their attendance and work ethic? Have they shown an ability to develop and retain clients? Everyone makes a big deal about rainmakers, but if the firm doesn't have partners who can keep clients happy enough to stick around, the firm has a turnstile, not a client base.
- Put them in a position to prove themselves. Whenever possible, it's wise to see if a person can do a job

before promoting him or her permanently. In the case of partner positions, a good option is to create a nonequity partner level or a similar type of position that can be used as a steppingstone. It's a setup that can benefit both sides, neither of which is locked into an ownership arrangement. Firms can say to potential full partners, "We're going to give you more business, and you need to manage a larger book." Then the firm sets up cri-

teria that will provide an accurate assessment of whether they would be successful as a partner. For example, a firm might tell a non-equity partner that it needs her to develop \$100,000 in new clients over the next year or two. The benefits to this are that the firm can see whether their CPAs can make the grade and the CPAs get a chance to prove themselves.

A good rule of thumb when choosing a successor is to not pick anyone whom the partners would not want to eat lunch with regularly.

Many firms make the mistake of promoting a CPA to partner because he has been there for a long time, and it's "his time" to make partner. Tenure is not a reason to make someone a partner. Not everyone is cut out for that role. Some

REPLACE THE ROLE, NOT THE BODY

Another mistake firms make when selecting a successor is failing to understand who would replace the roles being lost

with the departing partner. For example, if a three-partner firm has two partners focused on tax and one on audit, and the audit partner leaves, it can't just replace her with a tax partner. The firm needs someone to take on the audit book of business and fill the roles the retiring partner handles. This person also must be able to manage his or her current workload to create the capacity to take on new work.

That's why it's so important, regardless of whether a firm is a sole proprietorship or a multipartner firm, to take a holistic view of what needs to be replaced in a succession situation. Look beyond the departing partner's name. What role(s) does

she perform? Does he have a particular technical skill or license? Does she perform a lot of client hand-holding, rain-making, and administrative duties? Firms need to create a plan that doesn't simply replace a body with a body. Firms must choose a professional or professionals who can fill, as closely as possible, the roles that the retiring partner was handling.

THE FOUR C'S

While choosing someone with the "right" skill set is tremendously important, other factors tend to demand more of the authors' time when helping clients with this issue, especially in external sales situations. These are the four C's.

Chemistry. A good rule of thumb when choosing a successor is to not pick anyone whom the partners would not want to eat lunch with regularly. This is especially true if the successor is external, for three main reasons:

- **Partner-loyal clients.** As discussed in the August article ("The Long Goodbye," page 36), many firms, especially smaller ones, have clients who are loyal to a specific partner. In addition, most clients have no true yardstick to ascertain the skill set of professional(s) to whom the firm wants to transfer their account. Clients choose a firm more often than not because of a personal comfort level they have with a partner. If the current partners are uncomfortable with a potential

EXECUTIVE SUMMARY

- **Firms assessing internal candidates for succession should look at how they have performed in the past and also put them in a position to prove themselves.** It's preferable to see whether a person can do a job before promoting him or her permanently.
- **Don't promote a CPA to partner just because he or she**

has been with the firm for a long time. Tenure is not a reason to make someone partner. Some people are better suited for staff positions, and that's not a bad thing.

- **Firms should replace the role, not the body, when replacing a departing partner.** If a tax partner is leaving, for example, promoting an audit expert to

partner may not be the best move.

- **Consider the four C's—chemistry, capacity, culture, and continuity—**when selecting a successor for a departing partner. How a successor—whether an individual from inside the firm or an external firm in a merger—fits with the departing partner's firm is crucial to success or failure.

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successor candidate, why would clients be comfortable with him or her?

- **Staff.** Just as clients have choices when selecting their accounting firm, many staff members, especially the stronger ones, also have choices as to which firm they will work for. In many firms, key staff people also have significant client contact. Thus, once again, if the current partners are uncomfortable with a potential successor, why would the staff be comfortable with him or her? Client retention likely will affect the value of the partners' retirement package, and the loss of staff often leads to the loss of clients.
- **Working relationship.** A good transition plan requires years to take hold in many cases. Therefore partners/owners choosing their successors may be working with them for many years, both before they retire from full-time work and if they elect to stay on in a part-time role with the firm after retirement. With external sales, a good working relationship is critical if a transition occurs as part of a two-stage deal, a type of merger in which the

selling partners retain income and control for a period of time, usually two or three years, before shares are exchanged. The next installment of this series will cover the two-stage deal in detail.

Capacity. How many chargeable and nonchargeable hours does the retiring partner/owner devote to the firm? Is all the time she invests required to be replaced by partner-level professionals, or can some of that time be delegated to lower-level staff?

The authors have done many retreats for firms that have as many as a third of their partners five years or less away from reducing their time commitment to the

to another owner/partner only?

Culture. This term is used a lot but remains a vague concept for many. Think of culture in three ways: (1) What's it like to work here?; (2) What's it like to be a client here?; and (3) What's it like to be a partner here? The partners must consider whether this successor or merger candidate can cut the mustard in all three areas.

Continuity. Most accounting firms have their client base because their clients are comfortable with their people and approach to service. Clients tend to focus on fees, how services are provided, the level of hand-holding, and specialties, to name a few. In a merger, the successor

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firm. Until reminded about the capacity issue, these firms were confident they had an internal solution. Smaller firms need to consider hand-holding time an owner/partner may spend with clients. Can that time be assigned to staff or eliminated, or does it need to be transitioned

firm must avoid the clients' viewing this as a loss of the old firm and instead promote the gain of the new firm. If the successor firm intends to make wholesale changes upfront that will directly impact client experience, this can be a red flag for potential client retention issues. ❖

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JofA articles

CPA Firm Succession series

- Part 2: "The Long Goodbye," Aug. 2013, page 36
- Part 1: "Mergers Emerge as Dominant Trend," July 2013, page 52

Other JofA articles

- "Succession Planning: The Challenge of What's Next," Jan. 2013, page 44
- "Planning and Paying for Partner Retirements," April 2012, page 28
- "Traps for the Unwary in CPA Firm Mergers and Acquisitions," Aug. 2011, page 36
- "Accounting Firm M&As: A Market Update," Nov. 2010, page 30
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