



Planning for Succession- What Are Your Options?

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Presented by
Terrence E. Putney, CPA
CEO, Transition Advisors, LLC

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July 24- Seven Steps to Closing a Merger(CPA Leadership)

July 25 - How to Self-Assess Your Firm's Readiness for Merger, Acquisition or Sale (CPA Leadership)

August 21- Case Studies in Admitting New Partners

September 25 - Trends in the Marketplace for CPA Firm Mergers & Acquisitions (CPA Leadership)

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Polling Question

How many equity partners do you have in your firm?

- 1 (sole proprietor)
- 2 to 4
- 5 to 9
- 10 to 19
- 20 or more



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Assess the Readiness of Your Succession Team

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Assess Your Firm's Succession Readiness

Two Issues to Focus on
Regarding Partner Succession

- Need to replace
- Timing



Assess Your Firm's Succession Readiness

Two ways to replace a partner in your firm

- Role re-allocation
- Role succession



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Assess Your Firm's Succession Readiness

Evaluate Your Bench

Candidates: Ready in 2 + 2 years?



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Assess Your Firm's Succession Readiness

Partner Succession Projection

Partner	1-3 yrs	4-7 yrs	>8 yrs
A	RR		
B		RS	
C		RS	
D			RR
E			RS

RR=Role Reallocation RS=Role Succession

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Assess Candidate Readiness

Attributes of a Typical Partner

- *Leadership:* Provides guidance and is a role model for other partners and staff to achieve the firm's goals
- *Client Management:* Can manage an adequate number of client relationships profitably and effectively; clients see the person as their trusted advisor
- *Personal Productivity:* Is personally productive in producing services for clients
- *Growth:* Is able to develop new client relationships and expand services to existing clients
- *Firm Management:* Participates in the overall management of the firm and is a good businessperson
- *Technical Skills:* Has developed the technical skills necessary to provide exemplary service to clients and is known as an expert in a valuable service area

Assess Candidate Readiness

Attributes of a Typical Partner

- *Teamwork:* Puts the firm's interests ahead of their own and promotes a team attitude
- *Staff Development:* Assists in recruiting new talent, developing staff and is seen as a mentor to others in the firm
- *Community Involvement:* Is the face of the firm in the community
- *Professional Involvement:* Is involved in the profession outside the firm
- *Passionate:* Has unwavering loyalty to the firm and has a passion for making the firm successful
- *Communication Skills:* Excels in both written and spoken communication skills
- *Personal Investment:* Is on a constant journey to improve and sees every day as an opportunity to learn

Non-equity Partners

- 77% of firms over \$10M, 50% of firms \$2M to \$10M use this tactic*
- Path to equity?
- Permanent status
- Use in mergers



*2017 Rosenberg Survey



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Partner Development Programs

- *P3 Leadership Academy*, Boomer Consulting
- *Transformational Leadership Program*, ConvergenceCoaching
- *The Partner Institute*, The Growth Partnership
- The Leadership Academy, The Rainmaker Companies



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Assess Your Owner Agreement

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Polling Question

Does your firm have an owner agreement?

- 1) Yes, and it is signed by all owners
- 2) Yes, but not all owners have signed it
- 3) No, but we need one
- 4) No, and we aren't sure we need one

Past Webinar

Partnership/Shareholder Agreements 101

June 8, 2017

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Two Concepts

- Understanding what *really* creates value in your firm
- Financial terms



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What Creates Value?

Performance metrics?

Location?

Brand?

Profitability?

Clients?

Staff?

Services?



What Creates Value?

In most firms the most important driver of value
is partner roles and performance

*The keys to maintaining value when partners
retire/terminate are*

- Right successors to transition to
- Enough time to execute the transition plan
 - Proper execution of the plan

Principles of Value

Tying transition to your owner agreement

- Adequate notice period for termination
 - 2 years is normal
- Execution of written transition plan
- Penalties for failure to comply

Principles of Value

Two Pools of Assets

Intangible Assets

Tangible Assets



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Affordability=Self-funding

Available capital is the retired partner's foregone compensation.

Three uses for that capital:

- Pay the retiring partner off.
- Cost of replacing that partner.
- Some upside for the remaining partners for assuming the obligation and the extra work.

Example

Firm volume	\$3.9M
Ownership	35%
Capital	\$350k
Retiring partner comp and benefits	\$425k
Personal production	\$400k
Replacement resources (40%)	\$160k
Remaining buyout capital	\$265k

Example

Terms-

- Capital paid by end of first year
- Retirement paid in 5 years at 1X
- Payout retirement over 5 years
(works out to \$273,000 per year)

Example

- Year 1 net cash flow:
 - \$265,000 of available capital net of replacement costs
 - \$273,000 of retirement payments
 - \$350,000 of capital *equals*
 - \$358,000** of negative cash flow
- Years 2 thru 5 net cash flow:

\$265,000 *less* \$273,000 *equals* **\$8,000** of negative cash flow



Example

Alternative plan:

- Pay capital over 5 years
- Pay retirement over 10 years



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Example

- Years 1 thru 5 net cash flow:
 - \$265,000 of available capital net of replacement costs
 - \$136,500 of retirement payments
 - \$70,000 of capital *equals*
 - 58,500 of positive cash flow
- Years 6 thru 10 net cash flow:
 - \$265,000 *less* \$136,500 *equals* \$128,500 of positive cash flow



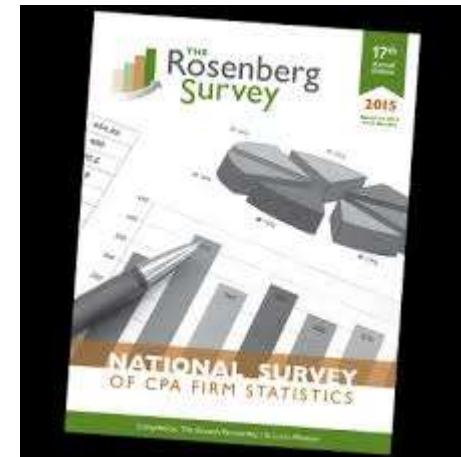
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Internal Valuation Benchmarks

- Average valuation of intangibles to revenue

– Firms over \$20M	77.4%
– \$10M to \$20M	76.7%
– \$2M to \$10M	80.3%
– Under \$2M	89.2%



Per 2017 Rosenberg Survey

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Admitting New Partners

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Polling Question

What issues do you see affecting your practice most in next year?

Succession for retiring partners

Admitting new partners

Client retention for retiring partners

Need for growth

Traditional Approach for New Partner Admission

Traditional approach-*handle like you are selling a portion of the firm*

- Value the firm as a whole
- Select a portion to sell to the new partner
- Allow new partner to pay over time often with compensation adjustments



Example

Firm volume	\$3,000,000
Valuation multiple	100%
Total capital	\$500,000
Total value	\$3,500,000
10% interest	\$350,000
Seven year compensation adjustment	\$50,000



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Techniques for New Partner Admission

Potential issues

- Cost to new partner
- What is the right amount of compensation to allocate to justify-
 - What the new partner invested?
 - What the existing partners were paid?
- How and when do you deal with acquiring more equity?
- When you do sell more equity to them, how do you consider the value they have helped create?

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Conundrum

What is fair to the selling or senior partners?

- How do we make this affordable for the new partners without giving away all the value we have created over many years?
- If we are going to increase new partner compensation so they can afford to make the investment, what are we accomplishing?

What is reasonable to expect from the new partners?

- If I am going to make a significant investment, shouldn't I have a significant return?
- I am not interested in making the same or less money to buy into this firm

Where is the recognition of sweat equity?

Example

\$3 million firm, 3 partners

\$1.1 million in profits, i.e., \$367k each

Base compensation \$200,000 each

Year end distribution paid % ownership \$500k

New 10% partner, \$50k/yr in profits

All used for buy-in

Benchmarks-New Partner Buy-ins

Average Capital (Buy-in) for New Partners*

<\$2M	\$142,000
\$2M - \$10M	\$173,000
\$10M - \$20M	\$171,000
>\$20M	\$147,000
Average all	\$168,000



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Alternative Technique for New Partner Admission

Alternative approaches-

- Separate the intangible value from the tangible value in your agreement
- Require investment for the tangible portion only
- Delay allocation of intangible value thru vesting and/or units allocated for growth and buyouts



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Past Webinar

Admitting New Partners

December 14, 2017

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Buyer's or Seller's Market? What's Your Firm Worth?

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Polling Question

In the next five years my firm is likely to:

Sell

Acquire a smaller firm

Merge into a larger firm

Not sure or do nothing

Is It a Buyer's or Seller's Market?

Depends on:

- *Market-location*
- *Size of seller firm*
- *Specialization*
- *Immediacy of succession needs*



Value is in the eye of the beholder!



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Value in a Merger

Traditional merger value
determined by
Successor firm owner agreement



OK, what's the multiple?

1X?



.75X?

1.2X?

.5X?

1.75x?



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Five Main Variables for Valuing a Practice

Cash up front, if any

- Time of year
- Seasonal cash flow net of purchase payments
- Treatment of accounts receivable
- Other upfront investment



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Five Main Variables for Valuing a Practice

Retention clause/guarantee

- Collection deals
- Fixed deals
- Limited guarantees



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Five Main Variables for Valuing a Practice

Profitability

- Seller's current profitability / billing rates
- Buyer's anticipated profitability / billing rates
- Tax ramifications of deal structure
(goodwill vs current deduction)

Length of the payout period



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Five Main Variables for Valuing a Practice

Multiple

- Cause vs effect
 - Multiple = effect
 - Balance = cause
- Basic rule:
 - Lower down payment, longer payout period
 - Higher profitability, longer guarantees = higher multiple

Market Issues

- Law of supply and demand
 - Where are premiums relevant?
 - Where are discounts relevant?
- Competition
- Motivated sellers



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Specific Firm Issues

- High turnover client base
- Poor profitability
- High profitability
- Specialty practices
- Your business plan



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Articles

JOURNAL OF ACCOUNTANCY

CPA Firm Succession Series

July, 2013 thru June, 2014

www.transitionadvisors.com/succession-planning.php



CPA Firm Valuation Series

October, 2014 thru December, 2014

www.transitionadvisors.com/valuing-accounting-firm.php



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For More Information

Visit the AICPA Succession Planning Resource Center

<http://www.aicpa.org/InterestAreas/PrivateCompaniesPracticeSection/StrategyPlanning:center/Pages/default.aspx>

The screenshot shows the AICPA Succession Planning Resource Center page. At the top, there's a navigation bar with links like Home, Interest Areas, Firm Practice Management - PCPS, Strategy & Planning, and Succession Planning Resource Center. Below the navigation is a sidebar with a "Succession Planning Resource Center" section containing links to Succession Planning Guide & Tools, Succession Calculator, and Succession Readiness Assessment. Another section titled "Browse" includes "By Topic" (Succession Planning, Small Firms, Practice Management) and "By Document Type" (Tools, Overview, Article, Guidance, Survey). A "Member Only Content" section is also present. The main content area features a title "Succession Planning Resource Center" and a brief description about strategic planning for growth and sustainability. It includes three images: two people at a desk, a stack of papers, and a hand writing on a document. Below this are three sections: "Succession Planning Guide & Tools", "Succession Readiness Assessment", and "Succession Timing Calculator". The "Succession Planning Guide & Tools" section has a sub-section for "Succession Readiness Assessment" which includes a "Succession Corner with Joel Sinkin and Terrence Putney, CPA". This corner features a video thumbnail of a man speaking and a list of topics such as pricing issues for midsize and large firm sales, mergers, and alternative deal structures.

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