An Inside Look at Partner Pay: What Owners Really Think

Partner compensation plans are one of those topics often raised during summer retreats. While partners had many other issues to consider during this year’s retreats given the continued recession and its impact on firms, the question of how much partners will be taking home this year—and how those amounts can and should be determined—is always toward the top of the list.

Despite the crowded retreat and planning agendas, a revise of the pay plans for CPA firm owners is something that—if it hasn’t happened yet—is likely to be looked at during this year of change.

It is always a topic that draws strong feelings, no matter what the economic situation. Research conducted by IOMA late last year and early this year makes it clear that partners are indeed concerned with what may lie ahead for their compensation after what was for many firms a long stretch of strong growth and huge profits.

While it may not be possible to come up with a perfect partner compensation system, one thing is clear: Firms may need to consider what a more perfect system is in the very changed reality of the current market.

To highlight the owner compensation issues that were of most concern to partners last fall and early this year, AOMAR is sharing highlights from the CPA Firm Critical Issues Survey. Partner compensation was one of the key issues explored in the research. (We reported on the survey findings about succession planning in the June issue of AOMAR; details about the survey and its respondents are on page 5 of that issue.) Highlights from the data portion of the research are in the accompanying sidebar.

Updating compensation plans. We asked survey respondents to share information about recent updates to partner compensation plans. Individual responses show that revising the plans has been much on the minds of partners, despite the many other issues fighting for time during partner planning meetings and retreats.

A new plan was “currently in process with new partners/partnership agreement,” wrote the director of operations at a firm with $6 million in gross fees and 30 FTEs (full time equivalent employees). “Changes relate to formula/accountability measures that were not previously part of the formula. The value of this system will allow us to apply it to future owners and create a structure that strengthens the owners’ commitment to non-billable responsibilities.”

New leadership is often the reason for a change in the partner compensation plan. “With each new MP (most recent change in MP occurred July 1, 2008), there are changes to the compensation structure,” said the chair of a $47-million firm with 250 FTEs. “Also, as we define new firm goals, the compensation allocation to specific items is readdressed.”
Sometimes, just reaching a certain number of partners is the impetus for change. “In 2006, when our fifth partner was added, the partnership agreement was reviewed and a graduated schedule was added for new partners. This system seems to be successful,” said the controller at a $9.3-million firm with 53 FTEs.

Other firms have been happy with a long-time plan. The compensation structure “has been in existence since formation of the firm (1988),” explained the managing partner of an 18-FTE firm with $3.5 million in fees.

“All systems have pros and cons, but what the partners like about the system is that we are all incentivized to service a client equally. What that means is a client gets the right partner and staff assigned to the engagement no matter who brings the client in. A client of the firm is exactly that—a client is not a client of any one partner. I worked in a firm where partner compensation was based on formulas and it really wasn’t a firm—it was a bunch of sole-proprietors, and the staff and clients end up losing in the long run.”

The struggle to change. Others admitted that despite updates to their plans there was room for improvement. “We changed to a compensation system approach about 10 years ago. In the interim, we have had three adjustments to the formula being used,” wrote a shareholder at a $16-million firm with 100 FTEs. “I do not like the system at all. There is a total absence of comparative data to determine how you are doing in connection with peers. The compensation committee is appointed, without terms or rotation, by the president, who also does not have a defined term. The plan has too much emphasis on the shareholder’s book of business.”

Newer firms have the benefit of not struggling with years of tradition. “Since we are a new firm, we are currently developing a plan that will include accountability for client retention and client growth, new client development, staff training and retention, firm administration and profitability, quality control efforts, and transfer of technical expertise to entire office and client base,” wrote the co-managing partner at a $1.7-million firm with 10 FTEs.

Quite a few more established firms wrote about the struggle to change their systems. “We have had the same structure for over 30 years,” said the managing member of a $13-million firm with 100 FTEs. “We recently formed a committee

What’s In and What’s Out for Partner Pay Plans?

We asked respondents to the CPA Firm Critical Issues Survey to describe how their pay is defined at their CPA firms. Formula systems and pay by ownership percentages or shares (both cited respectively by 35.1 percent of the respondents) are the most popular approaches now.

At CPA firms with more than 100 people, the overwhelming favorite is a plan determined by the managing partner and/or compensation committee, cited by 75 percent of respondents in that group. Other popular methods among these large firms are formula systems/balanced scorecards and other goal measurement/accountability systems (both cited by 41.7 percent).

Smaller firms favor ownership percentage or shares. This was the leading approach at firms with six to 10 people (40 percent), 11 to 15 people (57.1 percent), and 16 to 25 people (61.5 percent). The most popular approach at firms with 26 to 50 people is a formula system (77.8 percent), a significant lead over the second most cited option, ownership percentage/shares (55.6 percent).

For firms with 51 to 100 people, slightly more favor formulas (33.3 percent) than ownership percentage/shares. Twenty-five percent each favor a formula system including significant percentages for marketing; training and development; administration responsibilities; or other options.

When considering the responses broken out by gross fees of the respondents’ firms, some similar patterns emerge. For instance, firms with $25 million or more in gross fees strongly favor managing partner and committee determinations of partner compensation (88.9 percent).

And smaller firms still lean toward ownership percentage/shares as the measure of partner compensation: 46.2 percent of those with $1 million to $1.99 million in revenues and 75.0 percent of the $2-million to $2.99-million firms do so. The favored approach for both firms with $3 million to $3.99 million and $4 million to $9.99 million is a formula system (cited by 70 percent respectively of respondents in those groups).

A number of respondents indicate that their partner compensation system doesn’t fall into any of these classifications: 23.4 percent chose “other.” Some wrote in descriptions that included solo owners, division by individual office results, all partners decide upon compensation together at year end, and the tongue-in-cheek response of one respondent, “what’s left over after paying the bills.”
to review the pros and cons of our system and to recommend any modifications.”

**Open versus closed systems.** Whether an open or a closed system is best seems to vary by firm, and the respondents were fairly evenly divided on the issue. Open compensation systems make the pay information about other partners known to all owners; a closed system limits this information to the managing partner and/or compensation committee.

A $4.7-million firm with 45 FTEs has a system that is “open among owners, since all are equal,” said the firm’s president. “We consider it a good approach. All owners should be aware of each other’s compensation and what impacts the disparities.”

A $16-million firm with 100 FTEs uses a closed system. “We chose to do it that way to avoid open conflict among the shareholders over compensation levels,” explained a shareholder. “However, it has not worked because of the total absence of any comparable data in addition to the amount of compensation. In addition, shareholders are not held accountable to preset goals for the year.”

A combination approach is used by a $47-million firm with 250 FTEs. “We publish each shareholder’s guaranteed salary annually,” said the chair. “The bonus allocated to each shareholder is not specifically published and distributed to each shareholder, but each can determine the approximate allocation based on capital requirements for shareholders that are published and distributed.”

**Additional approaches:**

- Plan updated two years ago. “We recently split profit differently from equity. Profit is now split 50% evenly and 50% by equity” —Managing member, $1.4 million, 9 FTEs.

- “We are in the process of developing our structure now. We are incorporating more of a balanced scorecard approach” —Managing member, $16 million, 82 FTEs.

- “We review this periodically. We have used ownership percentage, but when you try to achieve a true team approach, it is difficult” —Member, $1.2 million, 8 FTEs.

- “We increased the compensation decided by the committee and lowered the amount determined by formula. We make annual changes that make sense as the firm evolves” —Managing partner, $35 million, 169 FTEs.

- “A two-tier structure is used. First, compensation has been determined. Second, profits are divided according to ownership ratios. For our firm, where each partner seems to contribute in different ways, the mechanism seems fair” —Shareholder/director, $1.8 million, 12 FTEs.

**Accountability issues.** Accountability by partners has been a hot topic for some time in CPA firm management. It is slowly making inroads as a compensation assessment factor in CPA firms’ compensation plans.

Some firms are embracing this as a factor in assessing partner pay and performance; other firms are resisting for a host of reasons. AOMAR was interested to see that there seem to be some very strong feelings on both sides of the accountability issue.

“Partners have been hesitant to accept ‘peer review’ by other partners in the firm, so the only accountability is through the compensation formula, which doesn’t really produce accountability,” wrote the managing partner for a $3.7-million firm with 24 FTEs. However, this firm is considering changes.

A similar view was expressed by a partner with a $7-million firm with 64 FTEs. “We don’t force partners to achieve goals. When we did, we had too many partners on the backs of others. We reward performance, not trying. This is harsh, but we spend about two hours per year debating partner compensation.”

Some firms see accountability as being a workable approach at the staff level. “It is instituted with the employees. Each year, approximately 10 percent of the budgeted salaries are allocated to a bonus expense account,’” explained the owner of a $500,000 firm with 4 FTEs. “If company goals
are met, bonuses are paid. In addition, summer hours are implemented (a four-and-a-half-day workweek), with everyone leaving early on Friday. This year we closed the office for the full week of Thanksgiving as an added bonus, with full pay.”

Other firms are embracing accountability in varying degrees for partners. “We establish goals for each member each year in counseling sessions with the managing member,” wrote the managing member of a 100-FTE firm with $13 million in fees. “Members are held accountable for their goals, but only indirectly through the compensation system (award of additional points). We are a collegial group, and we recognize that it takes lots of different talents spread among different individuals to make our firm work.”

At a firm with $47 million in fees and 250 FTEs, “Each shareholder is assigned office goals by the office partner in charge, as well as firm goals by the managing partner,” explained the chair. “These goals tie to various strategic initiatives where an individual shareholder can have a positive impact.”

Still others see accountability more as a core value than as something that needs to be written into the compensation plan. At a $3.5-million firm with 18 FTEs, there is no accountability rule “other than the partners meet weekly and you don’t want to let your partners down,” said the managing partner. “There is a strong internal sense of accountability for all partners. We also get in a room and argue out our disagreements/issues. This can be painful, but the firm and the partnership are stronger in the long run.”

For more information. Additional results from the CPA Firm Critical Issues Survey will be highlighted in upcoming issues of AOMAR. The complete results will be published in a report later this year.