

SUCCESSION FUNDAMENTALS – PART 3

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Now that you have determined how to pay the partner for his/her value in the firm and you have pinned down the mandatory sale of ownership date (MSO) so you can phase that partner out of serving in a leadership capacity within the firm, it is time to move on to the client transition process. This is the single most abused part of the succession process.

The reason why this part of the process is the most abused is because both sides, the partner nearing MSO (henceforth referred to as retiring partners or retired partners) and the remaining partners, are motivated to do the wrong things. For example, it is in the best interest of retiring partners to not transition their clients because if they don't, the firm will need to keep them around to continue to work on them after MSO. If this isn't bad enough, because they did not transition their clients properly, the retired partners have a great deal of leverage since they are now entitled to their full retirement pay and still have control over some or most of their client base. This allows the retired partners to gain additional benefits from the partner group by basically reselling their clients to them again. Unfortunately this situation is more the norm than the exception.

Well it doesn't take a genius to determine that it is not prudent to buy a client group more than once from the same person. And since CPAs are really smart, how can this happen so often? This brings us to the other side of the transaction. As a partner is nearing MSO, the remaining partners want to keep their income up and their workload down. The best way to keep the income of the remaining partners up is for the retiring partners to keep doing the work they are already doing. Maybe the retired partner will be asked to make an introduction here or there as part of their transition duties, but they are also expected to keep doing the work, which basically means keep interacting with the clients. This is exactly the opposite of what the transition process should be about. Transition is a deliberate process to move the retiring partner and the client away from each other while putting someone else in between them so a new relationship can be formed. We transition over a period of time so that even though the client knows a new partner or person is now responsible for their account, their friend – the retiring partner – is still around in case a big problem emerges.

Another barrier to effective transition is that the remaining partners simply don't want to pay for this effort. They just want to pay for work being performed. Our experience shows that this is an economically terrible choice. When you have a partner two years from MSO or retiring earlier if so chosen, the best uses of their time are:

- Taking on more technical work in the background,
- Spending time working their client transition plan,
- Introducing others to their personal networks,
- Using their skills and reputation to sell new business,
- Training others in their area of expertise,
- Acting as an ambassador for the firm,
- Serving on local boards of directors, and
- Other, related types of activities.

The concern of the remaining partners is often singular, “If they just take on that kind of activity, the retiring partners might not be earning the pay they are getting.” Well, I have two things to say about this. First, “get over it.” Yes, it is probable that the transitioning partners in their last two years as active partners would be overpaid by at least a little. But if you don’t get them to start focusing on the roles that are appropriate for post MSO now, you can rest assured that they won’t make an easy transition to those roles after MSO. And if they don’t make the transition and find a way to be valuable to the firm doing the work I described above in those last two years, then that would end the discussion as to whether the partner group should be open to keeping the retired partners around in some reduced capacity after MSO. The benefit of being able to draw this critical line is worth FAR MORE MONEY than any amount the remaining partners might pay the transitioning partners during those last two years.

And what I just described isn’t even the best benefit, financially or otherwise, to the firm during this transition period. The best reason is that during this two year period, the retiring partner will take a backseat the entire time to the person taking over the client account. This gives the new partner the time he/she needs to build a good relationship with their new clients. By doing this, not only is the cash flow value from those transitioned clients retained by the firm when the partner hits MSO, but it keeps that retired partner from holding the firm hostage for additional perks once retired. Trust me when I tell you that no amount of overpaying the partners during this transition period will equate to the ransoms we commonly see demanded from the retired partners and paid by the remaining partners that come in the form of office space, support staff, base salaries, bonuses, travel, continued leadership roles and so much more.

For the remaining partners, I am suggesting that you stop being greedy! Understand that the best money you will spend is to make sure the retiring partners do what is most important to the firm, which is to turn over their clients and take a step back in their visibility to those clients. And during this same timeframe, this transition period lets you test and see what other kinds of roles each retiring partner can fill to support the future success of your firm in a non-client management, non-leadership capacity. If the retiring partner can’t make the changes required during this period, then that tells everyone that when MSO occurs, that will be his or her last day of work. And if you don’t proactively take charge of this transition process and force the retiring partners to move into a transition phase, then based on our experience, they won’t. And while doing nothing might make the firm a little more money during the final two transition years, you will likely lose many multiples of that amount in the following years to pay for your sins of being unwilling to step up and take on your new leadership roles.

With this in mind, let’s talk about the transition process that we recommend. We break it down into a few simple steps:

- A transition plan is created for each retiring partner two years from his/her date of retirement or MSO (if your firm is transitioning clients who each generate \$300,000 per year or more, a three-year transition would be appropriate for these clients assuming they don’t already know and are comfortable with the partner who will be taking over the account management responsibility).
- The managing partner is the person responsible for creating the plan which outlines every client the retiring partner manages (if it is the managing partner who is retiring, then a new managing partner should be identified and he or she should be the one managing this plan as well as actively taking on the role of the managing partner position during this period).

- “A” level clients will be the first to be transitioned (this is because larger clients – “A” clients -- take more time to transition, typically need to be transitioned in an incremental manner and are more important to the firm as far as retention is concerned.)
- For each client, the managing partner should assign a new partner or manager to take over the client relationship. While the retiring partner’s input is important to this process as to who might be a good fit for the client, the retiring partner only has that – input. It is the firm’s call as to how to divide up the client base, and it is the managing partner’s job to put together a plan for this to occur.
- For each account, an action plan should be identified outlining the details of the turnover process. Those actions should be identified in chronological order, noting the timing and specifics for each contact, messages to be conveyed, and specific actions the retiring partner should or should not do.
- Standard operating procedures (SOP) should be established that outline allowable follow-up and involvement from retiring partners once transition begins. For example, if a client calls the retiring partner at home to talk over an issue, even though the retiring partner may be the firm’s preeminent source for that advice, he or she will be instructed to relay to the client that the newly assigned partner needs to be in on the discussion and will set up a time for that to occur. In other words, under this SOP, it is clear as to how the retiring partner is to become selectively more incompetent from a client interaction perspective as the transition plan progresses. Otherwise, why would the client ever accept the transition to the new partner?
- The transition plan for a retiring partner, once created, should be reviewed by the Executive Committee or the Board for specific concerns or areas of special focus that might have been missed.

Now, here the way this works. If the retiring partner follows the plan outlined by the managing partner, then for each client properly transitioned (in other words, the specific action plan outlined in the transition plan was executed), then those clients will be signed-off as having been properly transitioned. Regardless of whether those clients stay with or leave the firm, the retiring partner is not at risk. Why? Because if the retiring partner did the job that was asked of him or her to transition the client relationship, and the firm still loses that client, then it is the firm’s fault. In this case, the new partner had time to build a relationship but failed to do so (by the way, if this happens often, we have a problem with the remaining partner to whom the clients have been assigned that we need to deal with right away).

However, for those clients that were not signed-off as having been properly transitioned (and this decision is at the sole discretion of the managing partner (but could be escalated to the partner group if there is a major conflict), then the retiring partner is at risk. For any client who leaves within a specified time frame, that was deemed to be improperly transitioned, the retired partner’s retirement benefits will be reduced by one year’s annual fees for the lost client. We have seen the specified time frame or window range from two years to for larger firms, any time during the period in which the retirement benefits are being paid.

In our draft standard operating procedure business policy on transition (which we recommend that the firm always consult their attorney before using because we are communicating best business practices and not legal advice), we outline the following steps to determine the penalty for improperly transitioned clients who are lost:

1. For improperly transitioned clients lost during the retirement payout period beginning on the date of the retiring partner's retirement, the previous two calendar years' fees collected (starting with the year of retirement) for each client lost will be calculated and averaged.
2. The average annual fees for each client lost due to improper transition will be deducted from the Partner's Retirement Benefit.
3. At the onset of the transition plan the Managing Partner will assign a value to the referral sources or other key relationships based on past experience. The total value assigned to the clients and referral sources cannot exceed the Partner's Retirement Benefit. Inappropriate transition or disruption of a referral source or other key firm relationship will result in a reduction of value coincident with the value assigned.
4. The remaining Retirement Benefit will be recalculated based on the remaining term of the payout period to determine the revised monthly Retirement Benefit payment.
5. If the Managing Partner determines that the retiring partner is deliberately attempting to run off clients in advance of retirement to avoid a post-retirement transitioning penalty, these clients will be subject to the terms of this provision as if they were lost due to improper transition post retirement.

At this time, I want to point out that in the narrative above, referral sources are also included in this transition plan. And in our recommended process, a value is assigned to those referral sources. As well, there is a caveat that the total value of the client fees and assigned value for the referral sources can't be more than the retiring partner's calculated retirement benefit. But because we suggest averaging client fees over two years, and because important referral sources usually make up a short list, this usually leaves plenty of room to provide a value for referral sources. The key here is that referral sources need to be transitioned just like clients do and if improperly done, there should be some financial retribution for the lack thereof.

Notice as well that, because the reduction in the retirement benefit is about lost clients after retirement, we had to put in another clause because we found partners running off some key clients in advance of MSO that they thought might leave to void them from the lost client penalty. The thought here is "never underestimate what a retiring partner might do in order to shore up the value of his/her retirement benefit."

The key to this process is the action plan that the transitioning partner needs to follow for each client. For a small tax client, the directive could be as simple as a one-year transition and turning it over to whoever has been assigned to take over that account. For example, the action plan might be something like:

- Get on the phone and introduce Sarah to personal tax client A when the tax return information comes in
- Have Sarah conduct the tax return interview for client A
- Allow Sarah to manage the entire tax return preparation process for client A
- When client A comes in to pick up the tax return, have the client meet with Sarah to go over it
- During that meeting, come down and pop into the meeting for no more than five minutes. During that time, mention that you are happy to see the client and comment about how excited you are that you were able to get them assigned to Sarah who you believe is one of the most talented people in the firm.

As you can see, this action plan is simply about getting out of the way and being supportive of the change being made. And it only covers about a two-month period in the entire two-year transition plan, which is all that might be needed for smaller clients. On the other hand, for larger clients, the transition process might take the full two years to execute and needs to be broken down into shorter periods, such as every six months. For example, consider a larger client that the firm does planning and consulting for. Following is what the action plan for the first six months of the transition period might resemble:

- For the first six-month period of the transition plan for client X:
 - Take Jim along and introduce him in either a breakfast or lunch meeting with the client as the partner taking over their account within the first 30 days of the two-year transition process.
 - Set it up so that Jim has a reason to interact with the client as part of the preparation process for this year's upcoming executive retreat
 - Jim should be there to observe the entire two-day retreat facilitation
 - Identify and coach Jim on leading some part of the facilitation process during the retreat so that the client can see him in action and get comfortable with his participation
 - Have Jim follow up with the client on his own within three weeks after the retreat to go over the notes taken, actions identified and assignments made.

In this situation, in the first six months, while the retiring partner is still in control the engagement, the specific actions are all about allowing the client to become comfortable with the skills and involvement of the new partner.

Given the discussion above, let's take a look at a sample Word™ document Transition Form we have linked to this column (which was excerpted from our AICPA published book *Securing the Future: Succession Planning Basics*). First, list each client of the retiring partner on the form. Then, assign each of those clients to someone (A and high B clients to Partners, low B and C clients to principals or managers). Then, based on the transition year the retiring partner is in, counting backwards year from year three (only necessary if your firm has a number of very large clients), two or one (meaning the number of years left before the sale of ownership date), list the actions you want the retiring partner to complete. As you get closer to the date of mandatory sale of ownership, the action steps will basically require the retiring partner to selectively become incompetent. The point is ... this transition process is about making the retiring partner less attractive as the client's first point of contact, and constantly selling the idea that the new client service partner is the preeminent resource for the client to call. The process is about making the client feel like they are trading up to be connected to their new client service partner, not trading down.

It is up to the managing partner to monitor the performance of the retiring partner's action step accomplishments. Notice that at the bottom of each client section is a number of blocks with labels Q12 through Q1. This worksheet assumes that the managing partner is going to evaluate the transition plan performance each quarter (however, if you are using a two-year process, or even within a two-year process a semi-annual review, then just change and retitle the blocks accordingly). Assuming the retiring partner is performing as expected, you would enter a "Y" in that quarter's block or if not performing, an "N." In the end, if the retiring partner has an "N" denoting his or her lack of transitioning of a specific client, should that client leave the firm, one year's average annual fees will be deducted from the retiring partner's retirement benefit. If, however, there is a "Y" in the last block for a client, regardless of whether that client leaves the firm, there is no penalty to the retiring partner.

One commonly asked question is, “What if someone had “Y’s” for almost all of the quarters and then got “N’s” in the last few; it seems like the managing partner has too much power over this situation.” For the record, if someone has “Y’s” in most of the blocks and “N’s” in the final few, either one of two bad things has happened. Either the managing partner has become totally unethical in his or her evaluation (which we have never seen, but would likely be overruled by the partner group were it to happen) or, more likely, the retiring partner took actions with his or her clients that totally reversed the transition process. Consider this real life example when the retiring partner in his last few months of the transition period told all of his clients that they should move to a different firm because his remaining partners were idiots and did not know what they were doing.

Because the retiring partners have so much to lose if they do not transition their clients properly (one year’s annual fee deducted from their retirement benefit potentially anytime during the benefit payout period) and so much to gain by simply following the process (whether the clients leave or not, their benefit is protected), our experience is that they will follow the plan. However, the managing partner has a critical role to fill in this as well. If the managing partner does not identify the action steps for each client in advance, does not monitor whether the retiring partner fulfilled those expectations, and does not meet with the retiring partner on some consistent basis to provide feedback as to progress as well as how each client is being classified at that time (either quarterly or semi-annually for the final two years), then this process won’t work. This is about two-way accountability for both the managing partner and the retiring partner. If you follow this process, then you will find one of two things. First, if it flows smoothly, then you will be preventing the single most commonly violated process in succession management (which is proper client transition). Second, if the process is being ignored, you will find out much earlier that the retiring partner is not going to properly transition his/her clients and you can start taking action to salvage whatever relationships you can. But the good news is ... even if you can’t salvage those clients you at least will have an offset against the retiring partner’s retirement benefit to ease the financial burden.

We will pick up here in my next column on Succession. I hope you are having a profitable and successful tax season!!!