

CLIENT TRANSITION – PART 2

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It was brought to my attention recently by a CPA reviewing my old columns that I dropped the ball on Client Transition. He simply asked where he could find the follow-up articles regarding this topic. Since one of the last sentences in the first column was, “The next step is to delve into more detail as to what this plan might look like, so I will pick this up in my next column.” As I looked around for those articles I realized what the problem was, I never wrote them. So, here we go. Since the first article in this series was written in 2008, we have also included a link for you to catch up.

In the first column, we talked about the importance of a retiring partner transitioning his or her clients and why it works in the partner’s interest to do a poor job of it. The simple fact is, if you don’t get the partner to properly transition his or her clients before their retirement date and you can’t severely financially penalize them if they don’t, you will, in effect, have increased their retirement buyout. This is due to additional perks and income you will end up paying them *after* their retirement date to get them to do what they should have done *before* their retirement date.

We then talked about the importance of having a date specific (usually age) mandatory requirement for a partner to sell his or her ownership. We also talked about steps to follow to set up a three-year transition plan. And so, that is where we pick up.

As you know from the “Equity Allocation” column series, it is critical that your firm has a plan and policy to address the transfer of ownership. If you don’t, the lack of client transition and the extra retirement benefits you pay the retiring partner, will be the least of your problems. You have to leave the firm in the hands of the “Client Service Partners,” not the “Technical Partners.”

While the issue of requiring mandatory sale of ownership is currently in the news (*Wall Street Journal*, July 2010), we believe the real issue is much bigger than that. For example, in all of the partner/shareholder agreements we help firms update (rebuild is more appropriate), we always strongly recommend that any early vesting or early retirement rights be conditioned on the partner giving at least two years’ notice. In other words, while your firm may have set the mandatory retirement to the age in which full Social Security retirement benefits commence, you also might allow partners to retire with full or partial benefits before then. If that is the case, we like to build in a caveat that awards retirement benefits to a partner electing early retirement, without severe financial penalties, only if he or she gives a minimum of two years’ notice, assuming the client transition plan is followed.

The reasons for this are simple. First, if someone elects early retirement and all of their clients have been properly transitioned, the firm always has the right to waive this caveat. Second and most important, firms need time to plan around someone’s departure. We have seen cases where these kinds of requirements were not part of the agreement and disaster occurred. Imagine the following situation (a real situation changed to protect the innocent). The firm’s senior partner is retiring on schedule, based on the mandatory sale of ownership age. The remaining partners are diligently working to transition the clients, build relationships, and close skill and competency gaps left by the retiring partner. About six months after the most senior partner retires, his close friend decides to retire too, because his buddy is no longer around and work is not as much fun. This partner still has four years left before mandatory sale of ownership. However, he did not declare his intention to retire because he did not know he would feel this way two years ago. All of the sudden, a second large debt is handed to the remaining firm owners with no notice and everyone is overwhelmed and overburdened.

responding to the retirement of the first partner. And then a third partner, a few months later, barely within the vesting period, who was expected to be active for another eight years, decides that the firm is in trouble given that the partners were not ready to handle the extra workload of the second retiring partner. So she invokes her right to early retirement with no notice because she doesn't want the burden of putting in 80-hour work weeks to make the economics of the two retirements before her work.

The point of this story is that retirement benefits have to be carefully thought out and managed. While there is nothing wrong with paying early retirement benefits, that privilege has to be conditioned on notice and approval. At the end of the day, there needs to be processes in place that protect the firm, not just the partners.

Think of it this way, when a partner retires, firms are affected in three ways. First, they lose someone who manages client relationships. In order for the firm's survival and future economic success, we need to transition those relationships, both clients and referral sources, into others to nurture and grow. Second, the firm loses technical competency. This often comes in the form of some unique industry or service expertise and/or it might include the all-too-rare delivery of business advisory services that take advantage of a senior partner's years of general business experience. Whether through hiring or development, the firm needs time to fill the void left by the retirement of a partner for the unique competencies he or she delivered to the client base. And third, the firm has to replace the high-level, high-value work hours. In other words, there is a certain amount of work in the firm's backlog that takes a partner, or someone very experienced, to do. Therefore, firms have to find a way to backfill the actual billable hours performed by the retiring partner. To summarize, when a partner retires, the firm has to find additional resources to manage the client relationships, perform the unique technical work, and actually put in the high-level raw work hours. These three factors are a lot to manage and is why firm's that are cavalier about the partner retirement process are the firms that are likely to be in trouble soon.

We have now gone full circle and are back to the topic of this article, "Client Transition." Please refer back to the previous column on this subject for the details on the simple guidelines we suggest you follow for this process. These steps are summarized below:

- A transition plan will be created for each retiring partner three years from his/her date of retirement by the managing partner
- "A" level clients will be the first to be transitioned
- For each client, the managing partner should assign a new partner, or manager to take over the client relationship.
- For each account, an action plan should be identified outlining the details of the turnover process.

This takes us to the simple form we use (link to the Sample Partner Transition Plan, from the AICPA published book *Securing the Future: Succession Planning Basics*). Take a look at the form. List each client of the retiring partner on the form. Assign each of those clients to someone ("A" and high "B" clients to Partners, low "B" and "C" clients to principals or managers).

Now, based on the transition year the retiring partner is in (meaning the number of years left before the sale of ownership date), counting backwards Year Three, Two or One, list the actions you want the retiring partner to complete. If we are in Year Three (three years remaining), and the client is a small tax client, you may not list any action for this year, as this type of client can easily be transitioned in a year or at the most, two. If we are talking about an "A" level client,

then an action listed might be as simple as, “introduce the new client service partner by X date, and at the next meeting following that introduction, allow the new client service partner to run the client meeting.” As you get closer to the date of mandatory sale of ownership, the action steps will require the retiring partner to selectively become incompetent (even though they actually aren’t), and refer the client to the “more capable” new client service partner. The point is that 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 their new client service partner, not trading down.

The action section of the Sample Transition Plan might only have an entry or two for an entire three-year period for some small clients, but might have 10 or 15 specific actions on larger client relationships. It is up to the managing partner to monitor the performance of the retiring partner’s action step accomplishments. Notice 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. Assuming the retiring partner is performing as expected, you would enter a “Y” in that quarter’s block or an “N,” if not performing. In the end, if the retiring partner has an “N” denoting his or her performance relative to a specific client, and that client leaves the firm in the two years following retirement, 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 (see previous column for more on this).

A question that is always asked 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.” First, the managing partner can always be overridden by the partner/shareholder group. Second, 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/her evaluation and therefore will likely be overruled by the partner/shareholder group. Or, more likely, the retiring partner took actions with his or her clients that reversed the transition process. Consider this real life example: The retiring partner told all of his clients that they should move to a different firm because the remaining partners were not capable of sustaining quality service now that he wouldn’t be there to keep them focused.

As it seems with everything we cover, transitioning clients actually is not a big deal. It is easy to do properly. However, there needs to be a plan, it needs to be clear what we expect the retiring partner to do, and if those action requests are ignored, there needs to be severe ramifications for that neglect.