



Partner Compensation Methods & Trends

Presented by

Gary Adamson, CPA

Gary Adamson, CPA

- ▶ Recovering Managing Partner
- ▶ Over 20 Years as a MP of Brady Ware, a Top 200 Firm
- ▶ Grew firm from 9 to over 130+ people
- ▶ Now working with firms to reach solutions, faster
- ▶ Consultant, author and speaker



About Adamson Advisory

- ▶ Partner Succession
- ▶ Partner Retirement and Agreements
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- ▶ Partner Compensation
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Partner Compensation

Credits:

- ▶ The Rosenberg MAP Survey
- ▶ Inside Public Accounting




Rules of the Game



- ▶ Talk to me
- ▶ Polling questions from time to time
- ▶ Pepto Bismol slides



What's Important?

Success Factors			
Performance Evaluation	Production: # of widgets	Book of business Billable hours	Achieve goals
People Development	N/A	Not rewarded much	What could be more important?
Interpersonal Skills	Nice but not critical	Not rewarded much	Critical
Work Hours	How MUCH he works	More hours; more production	How SMART he works
Teamwork	Not critical	Lone Rangers allowed	Company is #1
Intangibles	Obey rules; be on time	Not rewarded much	Leadership; teamwork; Innovation

What Makes a CPA Firm Great?

Accountability

Leadership Development

Intangibles **Growth**

Skilled, Motivated Staff

The Right People on the Bus

Production Leadership & Management

Quality Work

Delivering Great Service

Compensate Partners For...



Executive

Production
Worker



Satisfying Clients
Growth (Finding)
Quality Work
Leadership
Great Staff
Accountability
Leadership Development
Right People on the Bus
Intangibles

Minding
Grinding

Evolution of Comp. in your Firm



Overall Factors in Splitting the Pie

- ▶ Return on capital
- ▶ Finder
- ▶ Minder
- ▶ Grinder
- ▶ Leadership/management
- ▶ Intangibles



Adamson's Three Comp Themes



- ▶ Judgment is always a critical part of the process.
- ▶ You are working with tangibles and intangibles.
- ▶ No two partners are the same.

Polling Question

Intangibles are a significant factor in our comp system.

- A. True
- B. False

Compensations Systems

- ▶ Equal
- ▶ Ownership percentage
- ▶ Slip of paper
- ▶ All partners meet to decide
- ▶ Formulas
- ▶ MP decision
- ▶ Compensation committee

Equal

- ▶ Best for really small firms or just starting out
- ▶ Appears to make it easy
- ▶ Can work with really high performers
- ▶ Is performance really equal?
- ▶ Reality.....

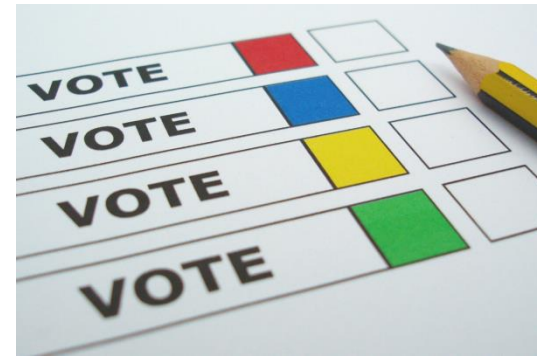
Are All Partners Created Equal?

Annual Fees	High To Average Ratio	Average Income / Partner	Ptrs./ Total Empl.	# Firms
> \$20M (34.4M avg.)	2.0	\$549,000	19/185	33
\$10-20M (13.6M avg.)	1.4	\$471,000	9/80	65
\$2-10M (5.4M avg.)	1.3	\$364,000	5/33	225
< \$2 million (1.1M avg.)	1.1	\$216,000	2.7/11	24

Ownership %

- ▶ Besides some rate of return on your invested capital what does your ownership percentage have to do with your contribution to the firm and what you should be compensated?
- ▶ Best for -- ----
- ▶ Rarely has anything to do with performance

Slip of Paper



- ▶ How it works
- ▶ Works for medium sized firms who don't like formulas and aren't ready to trust a committee
- ▶ Everyone gets a vote
- ▶ Will work in the three to eight or so partner range
- ▶ Tends to produce a narrow range

All Partners Meet to Decide

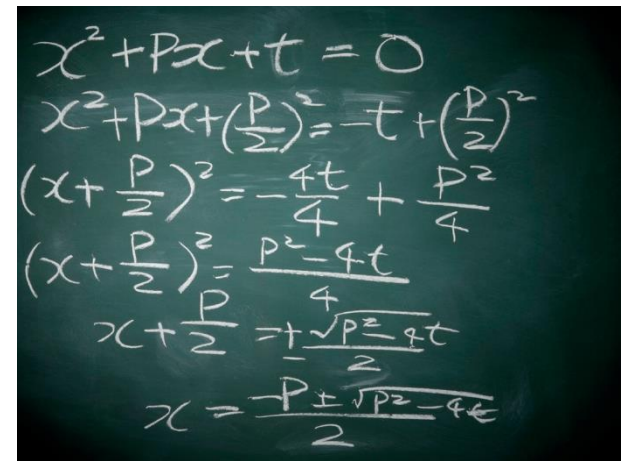
- ▶ Works for small firms – no more than five partners
- ▶ Each partner presents his/her case
- ▶ All partners have the statistics
- ▶ Lock the door and arm wrestle the result

MP Decision

- ▶ Committee of one
- ▶ Fairly common and fairly effective
- ▶ Works well for a firm with a highly credible and or dominating MP (more than likely the founder)
- ▶ The MP should know better than anyone the relative contribution of each partner

Formulas

- ▶ Most commonly used (especially in smaller firms)
- ▶ Eat what you kill theme
- ▶ Accountants love it
- ▶ Exists with a (relatively) lower level of trust
- ▶ Profit center approach
- ▶ Cumulative points
- ▶ Many problems
- ▶ Several examples



Handwritten derivation of the quadratic formula on a chalkboard:

$$\begin{aligned}x^2 + Px + t &= 0 \\x^2 + Px + \left(\frac{P}{2}\right)^2 &= -t + \left(\frac{P}{2}\right)^2 \\(x + \frac{P}{2})^2 &= -\frac{4t}{4} + \frac{P^2}{4} \\(x + \frac{P}{2})^2 &= \frac{P^2 - 4t}{4} \\x + \frac{P}{2} &= \pm \frac{\sqrt{P^2 - 4t}}{2} \\x &= \frac{-P \pm \sqrt{P^2 - 4t}}{2}\end{aligned}$$

Compensation Committee

- ▶ 3 to 5 person group makes the allocation
- ▶ Popular for 8 or more partners
- ▶ MP plays a major role
- ▶ Dominant in larger firms
- ▶ Focused on performance / contribution
- ▶ Rewards intangibles

Polling Question

- ▶ What compensation system are you using in your firm?
 - A. Formula
 - B. Compensation committee
 - C. All partners meet to decide
 - D. MP decision
 - E. Other

Partner Compensation Systems

	2 Ptrs	3-4 Ptrs	5-7 Ptrs	8-12 Ptrs	13+ Ptrs	2015 Total	2014 Total
Comp Committee	6%	16%	23%	53%	81%	32%	31%
Formula	25%	39%	39%	21%	8%	31%	30%
Paper & Pencil	3%	2%	4%	0%	3%	2%	3%
Ownership Pct	3%	2%	6%	4%	3%	4%	5%
MP Decides	13%	13%	13%	13%	3%	12%	12%
Pay Equal	38%	5%	1%	3%	2%	6%	6%
All Decide	12%	23%	14%	6%	0%	13%	13%
Open	100%	88%	77%	59%	40%	75%	78%
Closed	0%	12%	23%	41%	60%	25%	22%

Best Practices & Trends



Linking It All Together

Firm Goals,
Planning,
Core Values

Partner
Evaluations &
Performance

Partner
Compensation

Best Practices / Trends

- ▶ Movement from formulas to committees
- ▶ Movement from tangibles to intangibles (even with formulas)
- ▶ MP is key to the process
- ▶ Performance based
- ▶ Focus on strengths – not fixing things
- ▶ Not all at risk – base vs. bonus

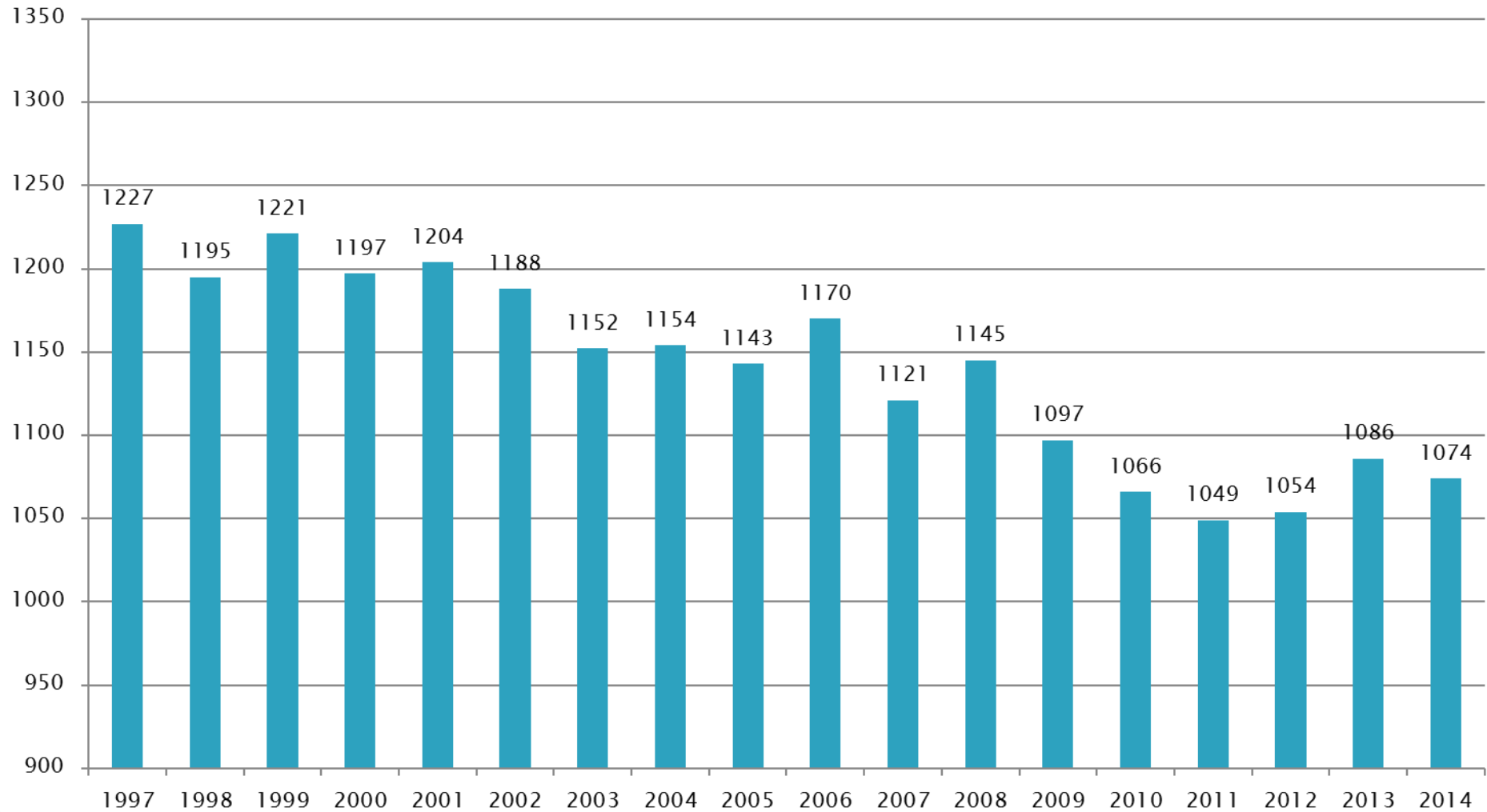


Best Practices / Trends

- ▶ Flexibility
- ▶ New business generation gets a premium
- ▶ Heavy dose of judgment
- ▶ Larger firms closing the process
- ▶ More: “what does the firm need you to do”
- ▶ Less: book of business and chargeable hours



Annual Charge Hours per Partner



Source: Inside Public Accounting, October 2015

Polling Question

Excelling at the following has the most value in our partner comp system:

- A. Bringing in new business
- B. Chargeable time
- C. Managing a book of business
- D. Other or none of the above.

Problems with Formulas



The Problem(s) With Formulas

- ▶ Promotes empire building and silos
- ▶ Difficult to move work
- ▶ Tends to promote everyone being the same
- ▶ How is leadership/management valued?
- ▶ How do you reward sales efforts and especially team sales?
- ▶ How do you decide what is measured and how weights are assigned?
- ▶ Intangibles?
- ▶ Good of the firm activities

If You Have to Have a Formula

- ▶ Three methods out there that work fairly well
 - Finder / Minder / Grinder
 - 20/50
 - Formula + Intangibles vote
- ▶ All need to include recognition for return on capital, payment for management and the intangibles

Finder, Minder, Grinder

The formula rewards:

- ▶ Finder – the sale
- ▶ Minder – who has the relationship and runs the engagement
- ▶ Grinder – doing the work (chargeable time)

How do you weight it?

Still carve out management, capital and intangibles

20/50 Method

- ▶ 20% of each partner's book of business
- ▶ 50% personal production realized
- ▶ Have to adjust to your firm
- ▶ Still carve out management, capital and intangibles first

Formula + Intangibles Vote

- ▶ Formula takes into account:
 - Interest on capital
 - The typical production metrics
 - Payment for management
- ▶ Plus a ballot or vote for intangibles
- ▶ Perhaps a bucket for special reward and or management's discretion

More on Comp Committees

- ▶ Larger firms have “evolved” through formulas and other methods
- ▶ Want the MP to have a major impact
- ▶ But, recognize that the MP may not want the job solo and partners may not want that either



Comp Committee Best Practices

- ▶ Communication/understanding of the process is critical
- ▶ Linkage of firm goals to partner goals to compensation must be clear
- ▶ The MP is the quarterback for the process and the liaison with the partners
- ▶ Partners must know how they contribute and what behavior and results will be rewarded
- ▶ Partners must respect and trust committee members



Polling Question

We have a partner goal setting process and use it in our compensation plan.

Yes

No

Comp Committee Structure and Process

- ▶ Three to five members
- ▶ Typically voted in, staggered terms
- ▶ Sometimes the Executive Comm. or Board
- ▶ MP permanent member
- ▶ Responsible for year end bonus and next year's salary/draw
- ▶ Meets once a year
- ▶ MP prepares the package for each partner for consideration by the committee
- ▶ Communication of results is critical

Comp Comm. Info Considered

- ▶ Achievement of goals
- ▶ New business development
- ▶ Charge hours – heavily weighted?
- ▶ Book of business \$ – heavily weighted?
- ▶ Profitability of book
- ▶ Working capital utilization
- ▶ Staff utilization
- ▶ Staff mentoring and development
- ▶ Firm leadership activities
- ▶ “Good of the firm” activities

Comp Comm. Info Considered

- ▶ Teamwork
- ▶ Movement of clients to other partners
- ▶ Client service/satisfaction
- ▶ Upward evaluations
- ▶ Partner cross evaluations
- ▶ Non-binding slip of paper
- ▶ Extenuating circumstances
- ▶ MP discretionary pot?
- ▶ Weighting of criteria?
- ▶ Partners nearing retirement

Comp Committee Decision

The hard part: so, how does the committee reach it's decision?



- ▶ CC reviews all data and ranks performance
- ▶ CC does a slip of paper exercise and, then tweaks
- ▶ MP takes the first shot and CC tweaks

Compensation Committee Challenges

“Do we have separate Executive and Compensation Committees?”

“Do I have the right to an appeal?”

“Aren't Compensation Committee members setting their own pay?”

“Do all partners vote on the committee's final decision?”

How do You Pay for Leadership, Management and Administration?

- ▶ Leading – worth more than your billing rate
- ▶ Managing – worth your billing rate
- ▶ Administration – worth less than your rate
- ▶ Too many firms pay their partners to do what a firm administrator should be doing.
- ▶ If your MP is doing the right things, the position should be one of the highest paid in the firm.

<https://dl.dropbox.com/u/37378359/article%20-%20MP%20101.pdf>

Ongoing Discussion

- ▶ Should making rain produce the biggest rewards?
- ▶ Is total comp at risk or only the year end bonus pool?
- ▶ Open vs. closed system
- ▶ Charge hours and book of business
- ▶ Recognition of intangibles – the soft stuff is critical but difficult for a lot of us (CPA's)

Moving to a Goal Based System

- ▶ Partner Compensation Checklist

<https://dl.dropbox.com/u/37378359/checklist%20-%20ptr%20comp.pdf>

- ▶ Partner Goal Setting

<https://dl.dropbox.com/u/37378359/partner%20goal%20setting%20article1.pdf>

Questions?



Thank You

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