Partner Retirement – Buyout Plans 2016

Presented By: Gary Adamson, CPA
Gary Adamson, CPA

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

- Partner Succession
- Partner Retirement and Agreements
- Mergers and Acquisitions
- Partner Compensation
- Firm Governance
- Partner Retreats
- Partner Coaching and Goal Setting
Adamson Advisory

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- Call us at 765-488-0691
Partner Retirement – Buyout Plans

Credits:

- The 2015 Rosenberg MAP Survey
- 2012 PCPS / Succession Institute, LLC (Bill Reeb) Succession Planning Survey
Rules of the Game

- Talk to me
- Polling questions from time to time
- Pepto Bismol slides
## 2015 Top Issues for the Profession

<table>
<thead>
<tr>
<th>2015 Top issues</th>
<th>2013 Top Issues</th>
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</thead>
<tbody>
<tr>
<td>1. Staff retention</td>
<td>1. Partner accountability / unity</td>
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<tr>
<td>2. Staff recruitment</td>
<td>2. Bringing in new clients</td>
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<tr>
<td>3. Partner accountability / unity</td>
<td>3. Staff retention</td>
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<tr>
<td>4. Seasonality / work compression</td>
<td>4. Succession planning</td>
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<tr>
<td>5. Succession planning</td>
<td>5. Staff recruitment</td>
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AICPA Survey of Firms with 21+ Professionals
62% of multi-owner firms expect succession planning to be a significant issue in the next five years. (about the same % as the 2008 survey)

54% of multi owner firms do not have a written plan in place. (improved from 65% in 2008)
1994 to 2009, lowest number of accounting grads
Even lower number sitting for the exam (150 hour requirement)
The BBB
76 million of us born between 1946 and 1964

61% of all CPA firm owners are over 50

1993 – 40% of AICPA members over 40

2008 – 70%

2016 - ??
Succession planning is not scrambling around to find a solution when the clock has run out. It is running your firm well now and having the people and systems in place.

Bill Reeb’s Definition of Succession Planning
Run Your Firm as if You Were Planning to Merge

Basics to Keep in Mind:

- Charge clients a fair rate (raise them)
- Invest in your firm – training, technology, etc.
- Regularly spend time with your top clients
- Stop giving away work to keep people busy
- Fire clients/run off marginal clients (or raise their rates until they run themselves off)
- Force the leverage of partners’ time
- Stop building your organization around people you know need to go
Run Your Firm as if You Were Planning to Merge

But the big one is:

Build Your Bench

- You have to invest in people
- Home grown or laterals?
- Create the career ladders
- Hire more than you need
- Accept (promote) turnover
A Great Succession Plan

- Rewards partners for building value.
- Rewards partners for transferring value.
- Causes partners to do what is right for the firm.
- Doesn’t allow partners to retire without telling anyone and removes the “mystery”.
- Motivates partners to transfer clients.
- Causes partners to stay connected to the firm after they retire.
1. We recruit future partners and leaders, not “just” accountants.
2. We are doing what it takes to be an “Employer of Choice”.
3. Our “mentoring program” has evolved to a “sponsorship process”.
4. We reward leadership and growth.
5. We understand that if we don’t develop our future partners no one will!
The 10 Commandments of Succession Planning - continued

6. We have a game plan to transition the key partner roles (not just client relationships).
7. We have a valuation process for the firm that makes sense.
8. Our deferred comp payouts are reasonable.
9. We have a story that will carry us into the future.
10. We invest in the future.
How Did We Arrive at the Cliff?

- Generational – Boomers, Xer’s, Millenials, etc.
- Busy
- No people plan
- Not enough new faces
- Promoting marginal people
- Partner comp plans focused on chargeable time
- “It’s just easier to do it myself and besides I’m a lot more efficient at it”
Does This Sound Like Your Firm?

- Too few if any younger staff
- Can’t keep the ones we have busy
- All Stars leave because....
- Managers and staff do the same work on the same clients, year after year
- You have an expensive work force – no leverage
- Partners are full with compliance work
- No talent to succeed you
So, What Do We Do? – Some Specifics

- Commit to plans for _____ and ______ and ______
- Tell your people the truth
- Treat the All Stars like All Stars
- Make the tough decisions sooner
- Control the number of “career” people
- Force the work down
- Change your partner comp plan
- Embrace non-traditional people
- Grow it
This best describes the succession plan for our firm:

A. We have a written plan in place that we believe will work.
B. We have a written plan in place that we’re not sure will work.
C. We’re working on a plan.
D. We don’t have a plan and we’re not working on it.
E. We don’t have succession issues.
What Bases Do We Have to Cover?

- Technical knowledge or expertise of the retiring partner
- The block of hours – getting the work done
- Voids left in firm leadership
- Client relationships
Client Relationships

- Currency that pays out the retiring partner
- Mandatory partner retirement and transition expectations
- Letting go...
- Rock the Boat to “Save the Whales”??
- Treat them like new clients.
Partner Retirement – Current Trends, Best Practices

- Inside deal – our topic today
- Outside deal, beyond our scope but the pricing is higher
Value of a CPA Firm

- Two pieces – capital and goodwill

- What’s different about a CPA firm compared to most of our clients?
  - Personal relationships - transition issues
  - Relative low buy ins and the concept of vesting
  - Longer term payout
Value of a CPA Firm

- Tug of war between the “old guys” and the “young guys”
- What is Fair?
- Risk if value is too low
- Risk if value is too high
Two Components of Value

- Accrual Basis Capital
- Goodwill
Accrual Basis Capital

- “Normalized” accrual book value
- Payout is cash or a short term
- Interest is paid
What is your firm worth to your partners in an inside deal?

110% of fees?
100%?
80%?
60%?
Polling Question

What percentage of fees are you using to value your firm?

A. 100%
B. Less than 100%
C. More than 100%
D. We don’t use a percentage of fees
E. We don’t have a buyout plan
# Multiple Used To Value Internal Partner Buyouts *

| % of Net Fees Paid for Goodwill | 2-4 Partners 90 Firms | 5-7 Partners 98 Firms | 8-12 Partners 55 Firms | 13+ Partners 36 Firms | All Firms  
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<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>2014</td>
</tr>
<tr>
<td>&gt; 100%</td>
<td>6%</td>
<td>10%</td>
<td>7%</td>
<td>8%</td>
<td>8%</td>
</tr>
<tr>
<td>100%</td>
<td>32%</td>
<td>17%</td>
<td>22%</td>
<td>17%</td>
<td>23%</td>
</tr>
<tr>
<td>90 – 99%</td>
<td>6%</td>
<td>12%</td>
<td>9%</td>
<td>6%</td>
<td>9%</td>
</tr>
<tr>
<td>75 – 89%</td>
<td>26%</td>
<td>22%</td>
<td>27%</td>
<td>19%</td>
<td>24%</td>
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<tr>
<td>50 – 74%</td>
<td>23%</td>
<td>24%</td>
<td>22%</td>
<td>17%</td>
<td>22%</td>
</tr>
<tr>
<td>&lt; 50%</td>
<td>7%</td>
<td>15%</td>
<td>13%</td>
<td>33%</td>
<td>14%</td>
</tr>
</tbody>
</table>

## Overall Valuation Percentages

<table>
<thead>
<tr>
<th>Year</th>
<th>Over $20M</th>
<th>$10-20M</th>
<th>$2-10M</th>
<th>Under $2M</th>
<th>All Firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td>69%</td>
<td>78%</td>
<td>81%</td>
<td>85%</td>
<td>79%</td>
</tr>
<tr>
<td>2013</td>
<td>76%</td>
<td>81%</td>
<td>81%</td>
<td>82%</td>
<td>81%</td>
</tr>
<tr>
<td>2012</td>
<td>71%</td>
<td>79%</td>
<td>80%</td>
<td>88%</td>
<td>79%</td>
</tr>
</tbody>
</table>

*Rosenberg 2015 MAP Survey*
So, where did 1x fees go?

- Inside vs outside
- Client transition issues (more mobility)
- Changing attitudes of younger partners
- Sweat equity
Value of a CPA Firm

Typical firm with revenue of $6,000,000

- Capital: $1,500,000
- Goodwill (80% of revenue): 4,800,000

Total Value: $6,300,000
Different Approaches to Allocating the Goodwill

1. We don’t?!
2. Equal
3. Fixed amount
4. Ownership %
5. Book of Business
6. AAV
7. Multiple of Compensation
AAV (Average Annual Volume) Approach

- Allocates the growth in the firm’s revenue each year to the current partners
- Normally based on relative compensation
- New partner gets 0 coming in unless they buy it.
- When a partner retires, their AAV balance is reallocated to other partners as retirement payments are made.
Relative Compensation Approach

- Best Practice

- Example
  
  Firm with revenue of $6 million
  
  $2 million bottom line, (1/3) before partners
  
  At 100% of revenue, the goodwill is 3x total partner comp
Relative Compensation Approach

- If goodwill is set at 3x partner comp, a retiring partner receives 3x his/her comp
- Generally based on the average of the highest three of the last five years, or five of last seven, etc.
- Why?
- 2012 PCPS Survey –
  - 18% of firms using 2.5
  - 35% of firms using 3.0
- Get the Comp right!
## Partner Retirement Systems *

<table>
<thead>
<tr>
<th></th>
<th>2-4 Partners 90 firms</th>
<th>5-7 Partners 98 firms</th>
<th>8-12 Partners 55 firms</th>
<th>13+ Partners 36 firms</th>
<th>2014 All</th>
<th>2013 All</th>
</tr>
</thead>
<tbody>
<tr>
<td>Multiple of comp</td>
<td>30%</td>
<td>43%</td>
<td>47%</td>
<td>53%</td>
<td>41%</td>
<td>42%</td>
</tr>
<tr>
<td>Book of business</td>
<td>14%</td>
<td>12%</td>
<td>7%</td>
<td>3%</td>
<td>11%</td>
<td>10%</td>
</tr>
<tr>
<td>Owner Pct.</td>
<td>28%</td>
<td>17%</td>
<td>7%</td>
<td>7%</td>
<td>17%</td>
<td>14%</td>
</tr>
<tr>
<td>AAV</td>
<td>13%</td>
<td>18%</td>
<td>27%</td>
<td>20%</td>
<td>18%</td>
<td>22%</td>
</tr>
<tr>
<td>Fixed</td>
<td>14%</td>
<td>8%</td>
<td>12%</td>
<td>10%</td>
<td>11%</td>
<td>10%</td>
</tr>
<tr>
<td>Equal</td>
<td>1%</td>
<td>2%</td>
<td>2%</td>
<td>7%</td>
<td>2%</td>
<td>2%</td>
</tr>
<tr>
<td>No provision</td>
<td>28%</td>
<td>7%</td>
<td>12%</td>
<td>7%</td>
<td>16%</td>
<td>19%</td>
</tr>
</tbody>
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*Rosenberg 2015 MAP Survey*
Polling Question

What method are you using to allocate firm goodwill to individual owners?

A. Multiple of compensation
B. Book of business
C. Ownership percentage
D. AAV
E. Other or we don’t have a buyout plan
Goodwill Payout Terms

- Deferred compensation structure
- Beware of code section 409A (still)
- Ten year payout common – sometimes shorter
- No interest or CPI
Vesting

- Low buy in - earn over time
- The firm wants partners to stick around for the long haul
- Two scales in use – age and years of service
PCPS Survey Results - Vesting

- Minimum years of partner service to fully vest:
  - 6 or fewer years, 30%
  - 10 years, 28%
  - 15 years, 13%
  - 20 years, 16%

- Minimum age to receive full benefits:
  - Age 55, 26%
  - Age 60, 23%
  - Age 65, 23%
Two Hybrid Vesting Examples

Plan A
- 20 years as a partner
- Age 65
- But, 50% limit until age 56

Plan B
- 25 years of employment, 0 credit until year 11
- Lose 2.5% per year for a departure before age 65
Death and Disability

- Payout is generally the same as a normal retirement
- Perhaps some “bonus” if insurance
- Define both ST and LT disability
- And, salary continuation, if any
Non Compete Provisions

- Rule #1. Consult an attorney in your state.
- True non-competes rare today.
- Payments for clients taken is the new norm.
- 100% common, up to 150 to 200%.
- Term?
- Payments for taking staff - 70% of firms in the PCPS survey do not have this in their agreements.
Maximum Payouts

- Protect the golden goose
- 5-8% of fees
- One firm, 12% of profits before partners
- How it works
- Only 36% of the firms in the PCPS survey have a cap!
Guarantees or Collateral

Forget it
Mandatory Retirement / Buyout

- Movement is to a mandatory age
- 2012 PCPS Survey – 47% have a mandatory age:
  - 55% age 65
  - 15% age 66 to 69
  - 14% age 70
- Why does the firm need to control it?
Our mandatory retirement age is:

A. Age 65
B. Under age 65
C. Over age 65
D. We don’t have a mandatory retirement age
Is this a partner position?

At firm’s discretion annually

Pay for specific duties / tasks. Normally billable time, new business, other projects.
  Charge time – typically 40% of billed time
  New business – 10 to 15% for three or less years.

Please, do NOT allow a “retired” partner to continue to do what they have always done and receive retirement benefits.
Notice / Transition Expectations

- Notice – two years
- Transition process that must be completed
- Most firms don’t penalize the retired partner for lost clients – only 20% of firms in the 2015 Rosenberg Survey.
- However......
Sample Client Transition Policy

1. Starts with a new client sales pitch:
   “If you go on a sales pitch alone, you get shot.”
2. Continues with team orientation to servicing clients;
   creating “multiple touch points.”
3. The firm maintains the partner’s comp during transition.
4. The firm drives the transition process.
5. Written plan (dates, milestones, success factors)
6. Different processes for different groups of clients.
7. Agree on announcements, internal & external.
8. Quarterly monitoring of progress.
Funding?

- Rare, but sometimes 401k or other retirement plan offsets
Buying In

- The days of the big $ buy-ins including value for goodwill are over
- $100,000 to $150,000
- Accrual balance sheet
- Financing?
Other Stuff

- Look back provisions upon a subsequent sale
- What is the split upon a sale?
- When do payments start upon an early withdrawal?
- Does a “for cause” termination affect the payout?
Questions?
Thank You

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