CPA LEADERSHIP INSTITUTE

Promoting Continuous Improvement in CPA Firm Leadership

Partner Retirement / Buyout Plans: Current Trends

Presented By: Marc Rosenberg, CPA

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ROSENBERG ASSOCIATES LTD.
www.rosenbergassoc.com

The Rosenberg Associates

Marc Rosenberg, CPA, President

- 23 years consulting to CPA firms
- Consultant, author and speaker
- 700 client firms from coast to coast
- Top 100 Most Influential People in Acting Profession – *Accounting Today*

  - 6 consecutive years

- Named one of the most recommended CPA firm consultants by *INSIDE Public Accounting*

Rosenberg is active with CPA firms:

- Facilitate retreats
- Partner compensation & retirement
- Succession planning
- Mergers
- Strategic planning
- Practice management reviews
- Partner relations and conflict
- Upward evaluation surveys

The Rosenberg Associates

- The Rosenberg MAP Survey – *Accounting Today* calls it "generally accepted as the barometer for CPA firm practice management."
- *The Management Catalyst* – quarterly newsletter sent to 3,000 CPA firms nationwide, free of charge

Value of a CPA Firm

Example: A $4 million firm

Value:

Capital	$1,000,000
Goodwill	4,000,000
Total	$5,000,000

Philosophy of a CPA Firm's Partner Retirement/Buyout Plan

1. As an owner of a firm with a well-defined street value, you have a right to your share of the firm's value when you leave.

Philosophy of a CPA Firm's Partner Retirement/Buyout Plan

2. Your share – the value of your efforts to build up the value of the firm:
   - Bringing in business
   - Managing the firm
   - Servicing/retaining clients
   - Developing staff
   - Capitalizing the firm
   - Working hard AND smart

Philosophy of a CPA Firm's Partner Retirement/Buyout Plan

3. Firms do not look at this plan as a savings plan that can be cashed in at full value any time the partner wants.

   Firms want their partners to stay around for the long haul.

Two main types of payments

1. Capital
2. Goodwill / Deferred comp

Capital

- Majority accrual basis vs. cash basis
- Payback often shorter than goodwill
- <u>With</u> interest

How to calculate a partner's share of the firm's capital

1. Partnership accounting rules

Increases with:	Decreases with:
•Income allocation •Capital contributions	•Draws/salaries to partners •Cash distributions

2. Ownership percentage
3. Relative income

Goodwill

Determining aggregate value

- 100% of fees?
- 90%?
- 75%?
- 50%?

Multiple Used To Value Internal Partner Buyouts*

	2-4 Ptrs	5-7 Ptrs	8-12 Ptrs	13+ Ptrs	All Firms
>100%	9%	8%	7%	12%	9%
100%	22%	24%	13%	20%	25%
90-99%	6%	7%	4%	15%	7%
75-89%	32%	25%	34%	9%	27%
50-74%	21%	20%	30%	23%	23%
<50%	10%	16%	12%	21%	14%

Overall Valuation Percentages (as % of Fees)				
	Over $10M	$2-10M	Under $2M	All Firms
2008	76.6%	79.6%	83.3%	79.1%
2007	75.8%	80.0%	82.2%	80.1%

***2009 Rosenberg MAP Survey**

What happened to one times fees?

1. Young people question one times
2. Fear of losing retiree's clients
3. Last one to turn out the lights
4. "Bad debt" reserve
5. Sweat equity issue
6. Partners wait too long to adopt a plan
7. Partners too busy with their own clients

6 Methods for Goodwill

1. Multiple of compensation
2.
3.
4.
5.
6.

- If partners earn 1/3 of fees as profits
- Then, 3 times comp = 1 times fees

Defining “compensation”

1. All income, not just “salary.”
2. You want partners to transition clients without fear of comp going down.
   - Average of highest 3 of last 5 years
   - 4 of last 7
   - Etc.

6 Methods for Goodwill

1. Multiple of compensation
2. AAV (Average Annual Value)
3.
4.
5.
6.

AAV Method

Incremental Growth Method
(Better name)

AAV

- A partner acquires goodwill as the firm grows once he/she becomes a partner.
- New partner gets no part of the firm's value <u>before</u> he/she becomes partner (unless the new partner *buys* it).
- The increase in the firm's fee volume each year is allocated based on a factor (usually comp).
- Merged-in partners credited for fees brought in.
- When a partner retires, his/her AAV balance is allocated to others as payments made.

AAV Illustration

Partners	Net Fees Jan. 1	Yearly Increase	Net Fees Dec. 31	Goodwill At 80%
Ptr A	1,000,000	90,000	1,090,000	872,000
Ptr B	850,000	60,000	910,000	728,000
Ptr C	700,000	60,000	760,000	608,000
Ptr D	450,000	60,000	510,000	408,000
New Ptr- E	0	30,000	30,000	24,000
Total	3,000,000	300,000	3,300,000	2,640,000
GW benefits at 80%	2,400,000	240,000	2,640,000	

6 Methods for Goodwill

1. Multiple of compensation
2. AAV
3. Ownership percentage
4. Client base
5. Equal
6. Fixed amount

Partner Retirement Systems*

	2-4 Ptrs	5-7 Ptrs	8-12 Ptrs	13+ Ptrs	All -2008	2007
Multiple of comp	26%	38%	59%	57%	41%	39%
Book of business	19%	15%	5%	3%	13%	14%
Owner Pct.	32%	20%	9%	13%	21%	22%
AAV	14%	18%	17%	22%	17%	14%
Fixed	8%	9%	8%	5%	8%	10%
Equal	1%	0%	2%	0%	0%	1%
No provision	26% (33 firms)	25% (25 firms)	9% (6 firms)	20% (9 firms)	22% (73 firms)	27% (87 firms)

*Per 2009 Rosenberg MAP Survey

Term of payout

- 10 years most common
- At lower payout levels, 5-7 years is more common

Interest

- Yes on capital
- Rarely on goodwill

Vesting

- To encourage partners to stay around for the long haul
- Decisions:
  - Based on years as a partner?
  - Age based?
  - Limit vesting until early retirement age?
  - Age for 100% vesting?

Two Common Vesting Methods

HYBRID

- 20 yrs as partner
- Full vesting at 65
- 50% limit until 56

SIMPLER

- Full vesting at 65
- Vesting reduced by 5% for every year before 65 that the partner retires

Payout nuances

- What if partner withdraws? When does he/she get paid? Right away or at early retirement date?
- Will you allow a partner to receive retirement payments while he/she works full time? Fundamental Rule #1 – Try to avoid this.
- Part-time? If clients transitioned, yes.
- Does a partner lose any or all benefits if he/she is expelled <u>with cause </u>and there is potential harm to the firm's reputation?
- Life insurance proceeds upon death should be allowed to be paid to estate right away.

Notice

- Should be at least one year prior to retirement (trend is increasing towards two years)

- Meaningful transition efforts should be a condition for receiving goodwill benefits

Two requirements to receive goodwill payments

1. Give proper notice.

2. Transition clients.

Consequence of non-compliance: reduced benefits at sole discretion of the firm

Client Transition Policy

1. Starts with 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, post-retirement plans)
6. Name the successors to the retiree – by client, target dates
7. Agree on announcements, internal & external
8. Quarterly monitoring of progress

From Sam Allred of Upstream Academy

Mandatory retirement

- Rigid requirements not very common
- At 65, if partner wants to keep working, should be approved by annual vote of partners.

Limits on annual payout

Usually 5-10% of fees

Funding

Very little except some life insurance for death and/or 401k matching

Reduce benefits if clients leave?

Overall: 18% yes; 82% no

- More common if the firm waits longer to put together buyout agreement
- More common if retiree has 1 or 2 huge clients
- More common if a substantial amount of retiree’s client base leaves the firm
- Specialties must be *institutionalized.*

Institutionalization of clients (For specialties & niches)

Institutionalization defined:

- No Lone Rangers
- If you develop a specialty and it goes away when you retire, <u>shame on you.</u>
- The firm is not dependent on one person to keep the specialty alive. The specialty <u>team</u> provides the service, not a Lone Ranger.

Institutionalization of clients

Evidence of institutionalization:

- Continual referral source stream from the same sources over several years.
- Other team members develop strong relationships with referral sources & clients.
- Other team members generate new business to a meaningful extent.
- Other team members develop expertise.

Retired partners working part-time

- Retiree is not a partner.
- The <u>firm</u> decides on the work.
- Pay: 30-50% of collected billable time
- Rarely any pay for non-billable work
- 10-15% for new business – 3 years
- An office and support

Health coverage

- Most firms don’t pay for retiree’s group premiums.
- Medicare utilized
- Retiree usually reimburses the firm for the premium.

Tax treatment of payments

- Capital is a non-taxable event.
- Goodwill is deductible by the firm and regular income to retiree.

Death and disability

- Most firms treat it the same as a normal retirement.

- Ways to make benefits more generous:
  - Accelerate vesting
  - Accelerate payout period

Withdrawing partners

- Pay 100-125% of fees for clients taken.
- Pay 30% of salary for staff taken.

What if firm is sold?

- Don’t use ownership percentage.
- Instead, use relative capital plus vested benefits.

Changes Over the Years

Feature	Used to Be	Now
Goodwill valuation	1 x fees	80% with big range
Use of multiple of comp method	Common	Dominant
Notice	1 yr & some 60-180 days	18-24 months
Reduce benefits if clients leave?	Yes, common	82% -no penalty

How firms afford the buyout payments
Part 1: The math

Assumptions

Comp = $300K
Add staff = $100K
Benefits: 3 times =
900K ÷ 10 yrs =
90K per year

Cash Flow

No pay to ptr	$300K
Retire pmts	(90K)
Add staff	(100K)
Cash ahead	$110K

Problem: Retiree wants to continue his comp AND start receiving his buyout. **That doesn't work.**

How firms afford the buyout payments Part 2: Good management

- Growth
- Respectable profitability
- Track record of developing staff to ptr, thus avoid age clustering of ptrs
- Track record of prior retirements

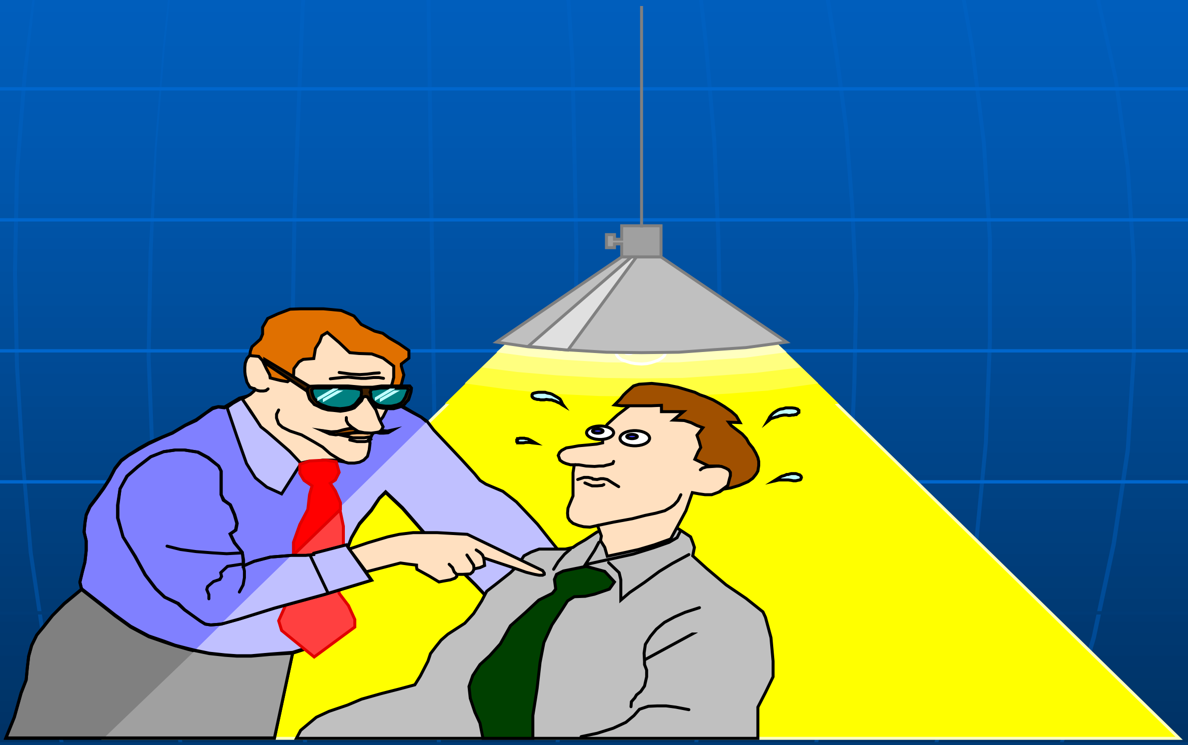
How to guarantee your firm will never have to worry about paying $1 of retirement benefits

1. Be stagnant

2. Making payments to a partner will give you heartburn

3. Unreasonable provisions in your retirement agreement

QUESTIONS?



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