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Why Nonequity Owners Can Enhance Your Firm's Results

Has your CPA firm added a nonequity partner yet? If so, you are part of a growing trend in the profession. CPA firms are using nonequity status to transition owners in or out of full equity ownership, and as a way to grant ownership status to such key firm leaders as firm administrators and marketing directors.

Adding this leadership level to the top management of the firm has provided many benefits for the firms that have done so. Those benefits include retaining key personnel and talent, the opportunity to try out individuals who are headed for equity status and to extend the training period for those CPAs, and a method to provide a slow and steady exit from full-time responsibilities for partners nearing retirement. Nonequity owners enrich and diversify the makeup of the entire partner group, particularly those who can bring an expertise in marketing, administration, and technology to the firm's leadership.

Though state law governs the percentage of owners who must hold a CPA license in each firm, many states do permit some owners to be non-CPAs. It is important to know your own state's (or states') laws before your firm starts offering ownership to a non-traditional class of leaders.

Your firm may also wish to alter the language of your partnership or incorporation agreement to reflect the changing definition of owner (which AOMAR uses to mean a firm leader who has owner-like responsibilities, whether or not that leader holds actual equity in the firm).

How nonequity partnerships operate. Our recent *CPA Firm Strategic Outlook* survey sought insights into how CPA firms are arranging and benefiting from nonequity partnerships now. We asked responding firms to tell us how nonequity partnership status is being used.

The most frequent application of nonequity status now is as a pre-partnership period for managers or supervisors who are making the transition: 62.3% of responding firms said they are doing so (see Table 1). Other uses are as a partial retirement vehicle (14.8%), for firm administrators (4.9%), and for marketing directors (9.8%).

Among the respondents, nonequity partners participate in such owner-type activities as serving on firm committees (18.7%) and on management or executive committees (14.4%; see Table 2). Some even vote on leadership issues (9.6%).

Nonequity partners may receive a fixed

income (15.5%), a bonus based on discretionary measures (15.0%), share in firm profits (11.8%), or receive a bonus based on firm profits (10.2%).

Success stories. Since nonequity arrangements may vary by firm, we asked survey respondents to share information about how their nonequity program works, as well as the benefits the firm is deriving from the initiative.

Most respondents using nonequity partners say it is working for their firms, and they plan to continue the program. One firm administrator called it a “key succession and retention strategy” for the firm.

“Nonequity ownership has worked well in retaining quality professional talent who have not yet developed their own ‘book of business’ to a degree that would sustain

their compensation,” explained the partner of a local firm with annual fees of \$2 million to \$4 million and 17 full-time equivalent employees (FTEs). “It has allowed us to keep these people and allow them to develop their practice.”

The program also permits more training and growth for soon-to-be equity partners. “It has helped a lot, allows for ‘early’ entry, and it gives the new generation an opportunity to succeed individually and then grow into equity positions over more time,” noted the managing partner for a regional firm with \$8 million to \$12 million in fees and 67 FTEs.

“We are just experimenting with it now, but it seems to be very successful, and we hope it will make the transition to equity partner much smoother,” said the managing

Table 1. How Nonequity Ownership Is Structured

	By Gross Fees								
	Overall	\$2M or less	\$2M to \$4M	\$4 to \$6M	\$6M to \$8M	\$8M to \$12M	\$12M to \$20M	>\$20M	
Firm administrator is a nonequity owner.	4.9%	14.3%	—	—	—	7.7%	—	12.5%	
Marketing director is a nonequity owner.	9.8	14.3	7.7	—	—	15.4	8.3	12.5	
We use nonequity status as a pre-partnership transition phase.	62.3	42.9	84.6	75.0	100.0	53.8	50.0	50.0	
We use nonequity status as a partial retirement arrangement.	14.8	14.3	—	—	—	15.4	33.3	25.0	
Other	8.2	14.3	7.7	25.0	—	7.7	8.3	—	
	By Number of Personnel								
	1 to 5	6 to 10	11 to 15	16 to 20	21 to 35	36 to 50	51 to 75	76 to 100	>100
Firm administrator is a nonequity owner.	20.0%	—	—	—	—	—	—	5.6%	12.5%
Marketing director is a nonequity owner.	20.0	—	—	—	8.3	—	—	16.7	12.5
We use nonequity status as a pre-partnership transition phase.	60.0	50.0	—	100.0	66.7	100.0	66.7	50.0	50.0
We use nonequity status as a partial retirement arrangement.	—	25.0	—	—	8.3	—	16.7	22.2	25.0
Other	—	25.0	—	—	16.7	—	16.7	5.6	—

(Source: IOMA)

partner for a local firm with 85 FTEs and \$8 million to \$12 million in fees. Others just starting out said it is too soon to tell how well the program is working.

Some firms report multiple benefits. "It has allowed us to retain senior people and prepare them for equity partner roles," wrote the managing partner at a regional firm with fees in the \$12 million to \$20 million range and 86 FTEs. "It also provides us an enhanced position for senior administrative people."

Several firms noted that a nonequity program is part of a bigger picture. "Although

we are currently not using nonequity, we anticipate that we will use it in conjunction with our pay-for-performance plan to keep talent in an equity position," said a shareholder with a local firm with three FTEs and earnings in the range of \$2 million to \$4 million.

Taking a similar approach to equity status and compensation is a firm with five FTEs and earnings of \$2 million or less, one of whose partners commented, "Nonequity ownership has helped our firm grow because individuals are more accountable for their actions since it directly affects their paychecks."

Table 2. Duties and Responsibilities of Nonequity Owners

	By Gross Fees								
	Overall	\$2M or less	\$2M to \$4M	\$4 to \$6M	\$6M to \$8M	\$8M to \$12M	\$12M to \$20M	>\$20M	
Make capital contributions.	4.8%	4.2%	4.8%	5.9%	5.6%	7.1%	0.0%	7.1%	
Serve on management or executive committees.	14.4	20.8	19.4	11.8	16.7	7.1	4.2	14.3	
Serve on other committees.	18.7	8.3	17.7	17.6	16.7	21.4	29.2	21.4	
Share in firm profits.	11.8	12.5	14.5	17.6	11.1	10.7	4.2	7.1	
Receive a fixed income.	15.5	20.8	9.7	11.8	11.1	25.0	16.7	21.4	
Receive a bonus based on firm profits.	10.2	16.7	8.1	11.8	11.1	10.7	12.5	—	
Receive a bonus based on discretionary measures.	15.0	4.2	11.3	17.6	16.7	14.3	29.2	21.4	
Vote on leadership issues.	9.6	12.5	14.5	5.9	11.1	3.6	4.2	7.1	
	By Number of Personnel								
	1 to 5	6 to 10	11 to 15	16 to 20	21 to 35	36 to 50	51 to 75	76 to 100	>100
Make capital contributions.	4.5%	—	—	5.3%	2.3%	8.3%	14.3%	2.5%	7.7%
Serve on management or executive committees.	18.2	27.3	—	21.1	15.9	16.7	0.0	7.5	15.4
Serve on other committees.	13.6	18.2	—	15.8	18.2	12.5	28.6	22.5	23.1
Share in firm profits.	18.2	9.1	—	15.8	9.1	16.7	14.3	7.5	7.7
Receive a fixed income.	9.1	27.3	—	10.5	13.6	12.5	14.3	20.0	23.1
Receive a bonus based on firm profits.	13.6	9.1	—	10.5	6.8	12.5	7.1	15.0	—
Receive a bonus based on discretionary measures.	9.1	—	—	5.3	18.2	16.7	21.4	17.5	23.1
Vote on leadership issues.	13.6	9.1	—	15.8	15.9	4.2	—	7.5	—

(Source: IOMA)

"So far it has served as a transition phase upon a merger," wrote a shareholder at a local firm with 62 FTEs and \$8 million to \$12 million in fees. "The incoming principals have one year before they can buy shares." This use of nonequity status is more creative.

Some firms reported that their use of the program needs tweaking. It "helps with retention, but is not working with client transition under the present system," said an owner with a local firm with 27 FTEs and \$2 million to \$4 million in fees.

"At this time, nonequity ownership is not

permitted in our state; this is the driving reason to not pursue it," commented the chief operating officer of a local firm with \$12 million to \$20 million in fees and 86 FTEs. "However, to retain key positions in the future, it is an issue the firm will need to address."

For more information:

Complete results of the survey are in the book *CPA Firm Strategic Outlook 2007*, available now from IOMA. Visit www.ioma.com for more information and to order. Cost: \$495 plus shipping and handling. □

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