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SuccessionPlanning



No heir, apparently

If your firm doesn't have a succession plan — get one!

BY LIZ GOLD

Do you know how much longer your firm's partners want to work?

The answers might surprise you — and help you transition more easily into the future.

"One of the first questions we ask when

a firm seeks assistance for succession is to take a survey of the partners and ask how many more tax seasons each wants to work full-time," said Joel Sinkin, principal of Accounting Transition Advisors, a New York-based consulting firm specializing in CPA mergers, acquisitions and succession plan-

ning. "A lot of people ask what seems like the same question in the wrong way. Like, 'When do you want to retire?' There's a plethora of options between working full-time and retirement."

For Sinkin — who has been involved in

See SUCCESSION on 37

SUCCESSION

from page 1

the closings of more than 900 CPA firm mergers and acquisitions in the past 18 years — said that 75 percent of his business comes from those firms that don't have an internal succession plan in place and recognize that they have a problem.

Succession planning is about sustaining the firm through-out constant change, which should be a regular and ongoing practice, according to a 2008 Private Companies Practice Section Succession Survey released by the American Institute of CPAs.

The survey, which netted about 400 responses from firms of various sizes, showed that firms are stepping up their strategies for succession planning since last measured in 2004 — but not by much.

In the 2008 poll, 35 percent of multi-owner firms and 9 percent of sole proprietors had a written succession plan in place, compared to 25 percent of multi-owner firms and 9 percent of sole proprietors in 2004. While these statistics show slow action, more firms do acknowledge that succession is on their radar. A total of 67 percent of multi-owner firms and more than 50 percent of sole proprietors believed that succession planning would be a significant issue for them in the future.

"Our thinking is, if more people aren't preparing for this, their options are going to be limited down the road," said Mark Koziel, a CPA and senior technical manager at the AICPA. "It's not unlike our clients and the rest of small-business America. It's not like we're alone here, but we have such a great opportunity to be prepared. If we want to maintain the value of the firm, whether we are going to transition it internally, sell it to the open market or merge into another firm, then we need to

have the right firm practice management practices in place to make sure that we maximize our value."

Koziel said that the survey revealed firms to be "fairly consistent" in their relationship to succession planning, but he was particularly interested in some of the changes starting to pop up in the area of partner compensation.

"It's not just about the book of business anymore," he said, adding that salary or base draw is still the No. 1 element of many firms' compensation system.

Yet it has decreased by 4 percent since 2004. "Now you see a greater number of elements that are starting to really play into the partner comp role. Client satisfaction goals went up, leverage of work being done by other staff members, business transferred to other partners or managers. [It's] forcing succession through the pocket-book of the partners. Part of our recommendations for firms is to take a look at that list and basically start from the bottom and work your way up, because those are the early adopters in some of these newer systems."

The survey, aside from providing a succession best practices section towards the end, offers more detail for multi-owner firms and sole proprietors than 2004 — and of those multi-owner firms that participated, 63 percent are expecting at least one owner to retire in five years. Some 32 percent of firms will have two or more partners leaving within the next five years. Surprisingly, 38 percent of these firms' senior partners revealed that they felt the younger partners weren't ready to step up to leadership positions, while in 2004, 86 percent of firms surveyed said that the firm and clients of the senior owners would be transitioned to the remaining owners or incoming owners. This year that figure has dropped to 79 percent.



Mark Koziel

"A lot of these firms are still in their first-generation partners," Koziel said, adding that the AICPA would be launching an online section through its Succession Resource Center targeted at developing new leaders. "They came up through the school of hard knocks. I think some partners forget the early days of their firm and some of the mistakes they too made along the way. They're seeing

that in some of their people and saying, 'Well, they are not ready.' Well, they haven't had the opportunity to grow like the senior partners at the firm, yet. They will learn that along the way."

TAKE A LOOK INSIDE

McConnell Jones Lanier & Murphy LLP in Houston is among those firms that have decided to promote from within. It created two new principal positions to

provide a clearer ranking system to the partner track. The principal role, as described by Thomas Jones, one of the firm's four founding partners, is viewed as a partnership position without the equity stake or liability.

"We have just in the last couple of years started to deal with the issue of succession planning, and obviously that involves bringing more people

See **SUCCESSION** on 38

A PLAN FOR SUCCESSION PLANNING

Joel Sinkin, a principal at New York-based Accounting Transition Advisors and a specialist in mergers, acquisitions and succession planning, offers 10 tips on how to implement a firm succession plan:

► **1. Make sure the operating agreement covers all the types of succession needs.** You should have language that details how you will handle voluntary buy-outs, disability, retirement, involuntary terminations and penalty buy-outs. I get calls from people monthly that say, "We're a 10-partner firm and we have two partners looking to reduce their time commitment and we have to value their equity." And I say, "How does your operating agreement handle this?" And they say, "It doesn't really specifically discuss that." Meaning, they don't really have an effective agreement. The first thing you should do is have an agreement that addresses all the types of terminations and all the necessary issues.

► **2. Review the operating agreement as often as twice a year.** A lot of people who do have a complete agreement put it in a drawer and never look at it again. For instance, the trend is for firms that have their buy-outs based on equity applied to a market-based valuation to move to a compensation-based formula. Make sure your agreement works for your situation and is current with market trends.

► **3. Plan ahead.** You should, if possible, plan five years in advance of a partner retiring or substantially reducing their time commitment to the firm. When a partner is five years or less from a substantial reduction in time, there should be a plan in effect that will transition the relationships, the workload and all their roles gradually so their clients are retained and the firm isn't blown away by having to do this in the 11th hour.

► **4. Be realistic.** A lot of people try to replace the body instead of the role. You can't take a rainmaker away and replace them with a technician.

► **5. Value the equity or the ownership that is being sold appropriately.** Many firms use valuation methods that are what is currently top dollar in the market for a third-party transaction but will result in an unrealistic financial burden for the partners that are left in an internal succession. That often results in disaster for both the remaining partners and the retired ones.

► **6. For external successions, choose the right successor on four levels.** Professionally,

make sure they have the skill set needed to serve your clients. Secondly, that the successor has the financial resources to complete the transition and succession. On a cultural level, test your fit with the successor with this simple benchmark: If you don't want to eat lunch with someone, you shouldn't enter into an affiliation with them. Lastly, structural issues: If your practice is very geographically sensitive, don't affiliate with someone who is going to move the practice 40 miles away.

► **7. Have a proper transition plan.** It's good to say, "I'm five years from getting out and you're going to be my replacement." That's not a transition plan, that's a fact. A transition plan for clients is, for instance, "This year you (the transitioning practitioner) will mention that they are using me (the successor) in the back office to help review issues; the second year, you're going to bring me with you to meet the client; the third year, I'm going to meet the client alone and you are going to call the client and remind them I'm meeting with them; the fourth year we're going to go together; the fifth year I'm going to go



Joel Sinkin

alone again; and in year six, we shouldn't even have to make an announcement, by then the client should be transitioned."

► **8. Document your deal thoroughly.** Never agree to agree later. I have worked with firms that have reached a verbal agreement on important issues and then when push comes to shove, suddenly they realize they didn't have a complete written agreement. You can never have a trial period that mirrors what a merger would be like. Firms will have a glorified trial period, it ends successfully and then they can't agree on the final document. Document all of the financial and legal issues completely in the beginning.

► **9. Leave room for the unexpected.** One of my favorite sayings is if there are 50 things you have to know about doing a deal, the smartest of us are going to think of 30 to 35. If you are involved in a merger or acquisition, there can be a lot of unexpected time commitments and expenses.

► **10. Get help.** Unless you've done a lot of deals already, you haven't gotten beaten up enough to learn the lessons. When you are in the middle of the fire often all you see are flames, not the safe way out.

IN BRIEF

► **RULING MAY INCREASE INSURANCE STOCK REFUNDS**

WASHINGTON, D.C. — A recent court ruling by the U.S. Court of Federal Claims could increase claims for tax refunds by insurance policy-holders who sold stock in insurance providers that went public.

The ruling could also apply to current shareholders, including stakeholders in carriers, such as MetLife and Prudential Financial, which converted from mutually owned companies to public entities. The ruling says sales of stock in such companies should not be subject to capital gains tax if the amount received is less than the taxpayer's cost basis in the insurance policy.

"It's going to affect anyone who has received stock in a demutualizing transaction, or cash in lieu of stock," said Burgess Raby, the attorney who represented the plaintiff, Eugene A. Fisher. He argued that Fisher, the

trustee who oversaw a trust that held a Sun Life policy, had paid premiums on the policy, which should count toward the cost basis in the stock.

Raby estimated that there are 30 million policy-holders of demutualized insurance companies. "Each of those policy-holders, depending on how they received the compensation in the demutualization transaction, will have to evaluate how the case affects them, or their professional advisors will have to determine it for them," said Raby.

C.D. Ulrich, a CPA in Baxter, Minn., has been tracking developments in the matter at his Web site, Demutualization.biz, and includes advice for filing claims for tax refunds. However, he cautions that policy-holders should be aware of the three-year statute of limitations that applies in the case.

"Anyone who paid zero-basis taxes should file an immediate amended return to avoid the statute of limita-

tions running out," he noted. He also has been compiling a database of claimants for a possible class-action case. He estimates that there were 11 million policy-holders each with MetLife and Prudential, with total distributions exceeding \$20 billion.

Ulrich faulted the IRS for not doing more to inform policy-holders of their rights: "It certainly is contradictory to their mission statement that policy-holders pay only the proper amount of tax, not too much or too little."

► **CFO OPTIMISM PLUMMETS**

FLORHAM PARK, N.J. — A quarterly survey of CFO attitudes shows that the level of optimism about the economy is in steep decline. The survey of over 200 corporate CFOs by Financial Executives International and Baruch College's Zicklin School of Business showed optimism about the economy plunging to an all-time low in the sec-

ond quarter. Optimism about the CFOs' own companies remained relatively stable in Q2, however. The top business challenges for CFOs were expense control and competition.

More than half of the CFOs surveyed believe that the price of oil will reach at least \$160 per barrel or higher in six months. The majority are changing their behavior to accommodate oil prices, including increasing prices, cutting back on corporate travel and becoming more ecologically responsible.

Less than a fifth of the CFOs surveyed said they would take advantage of filing or preparing financial statements in accordance with International Financial Reporting Standards if the opportunity was available, while more than half would not. Nearly half of the CFOs said it would take only two to three years for their companies to adapt to IFRS should they decide to do so.

SUCCESSION
from page 37

into the partnership ranks," said Jones. "We started that process with a couple of people both in the audit and tax area, who we believe will be around and can carry the firm on after we've left."

The firm's partners — all of whom are in their 50s and within three years of each other — started to think about succession planning.

"It was just the realization that we are getting up in age," Jones said, adding that he foresees the firm completing a written succession plan by the fall and eventually expanding the

firm nationally in the near future. "While we suspect we will be working past the age of 60, we did really want the firm to go on. You basically decide, 'Hey, we really believe we've built something of value here that we would like to see sustain itself.' Certainly we have been approached about mergers and we have thus far steadfastly said that we're not interested at the moment in doing that."

There are two main ways to plan for succession — externally and internally. Some firms sell themselves, or choose to be merged or acquired into a larger organization. Other firms do an internal assessment, decide whom management could successfully pass the baton to and go from there. Regardless of the choice made, many firms opt to bring in an outside consultant to help facilitate a succession plan strategy, which includes having a written document to guide them along the way.

"You have to be able to envision the future you'd like to create," said Patrick Sweeney, executive vice president of Caliper, an international management consulting firm based in Princeton, N.J., adding that

the first questions to ask are about what the position and organization will look like once the succession has taken place: "Understand the position [being replaced], recognize that this is a very difficult and tender time, so it's developing an ideal profile of what that next leader would look like, and then it's a matter of looking around to see if you have someone in that profile you described."

He added, "Grooming and creating a connection between the leader that is stepping down and the leader that is stepping up is crucial. It's not just professional, but extremely personal. It's a crucial crossroads."

Wayne Pinnell, managing partner at Haskell & White LLP, an 11-partner firm headquartered in Irvine, Calif., understands the emotions and critical planning involved in succeeding a firm leader.

He took over the reins of his current position in 2004, a mere eight weeks after one of the firm's founding partners was diagnosed with lung cancer. Succession plans were already in the works for Pinnell to take over for managing partner Steve Haskell, but, not surprisingly,

were accelerated once news broke of Haskell's illness.

"It happened really fast," Pinnell recalled. "I was probably the obvious choice to succeed Steve at that point in time based on our personnel make-up and the histories we have with the firm, but when we announced Steve was resigning from the



Thomas Jones



Wayne Pinnell

position, there was a little bit of shock and jaw-dropping because we did it at the partner retreat. It took a little time to process the fact that Steve was no longer the managing partner and then we had to, in that same meeting, very quickly get around to going through the partnership election for the managing partner. So it was kind of this [sur-real] moment where everybody was in a state of confusion, like, 'What do we do now?'"

Once other management and staff were told about the change, Pinnell worked closely

with Haskell to create action plans on how the transition process would evolve. The firm also — for the first time — hired a professional public relations firm to communicate to its clients and community about the change that was taking place. At the same time, the firm started looking at its partnership and retirement agreements and invested in insurance plans for both the firm and its individuals. They also hired a partner to specifically take over Haskell's book of business, a process that only lost them a few clients.

Though Pinnell said that his firm doesn't have a formal written succession plan, there are elements that are written — such as a strategic plan, the firm's partnership agreement, the insurance requirements, and the counseling and mentoring program for all personnel in the firm.

Said Pinnell, "There's no such thing as a plan that you write and put on the shelf. A fluid plan has to be a living document that is adjusted every time there is a change in the environment. It's never complete." **AT**

ADVERTISER INDEX

Advertiser	Page
1st Global	19
AccountantsWorld	39
ADP Small Business Services	11
CCH, a Wolters	
Kluwer business	40
Drake Software	4
Genworth Financial	9
NACVA	20
Nationwide Insurance	25
State Farm	21
Thomson Reuters	2, 7, 13, 15, 17, 23
Union Bank of California	27