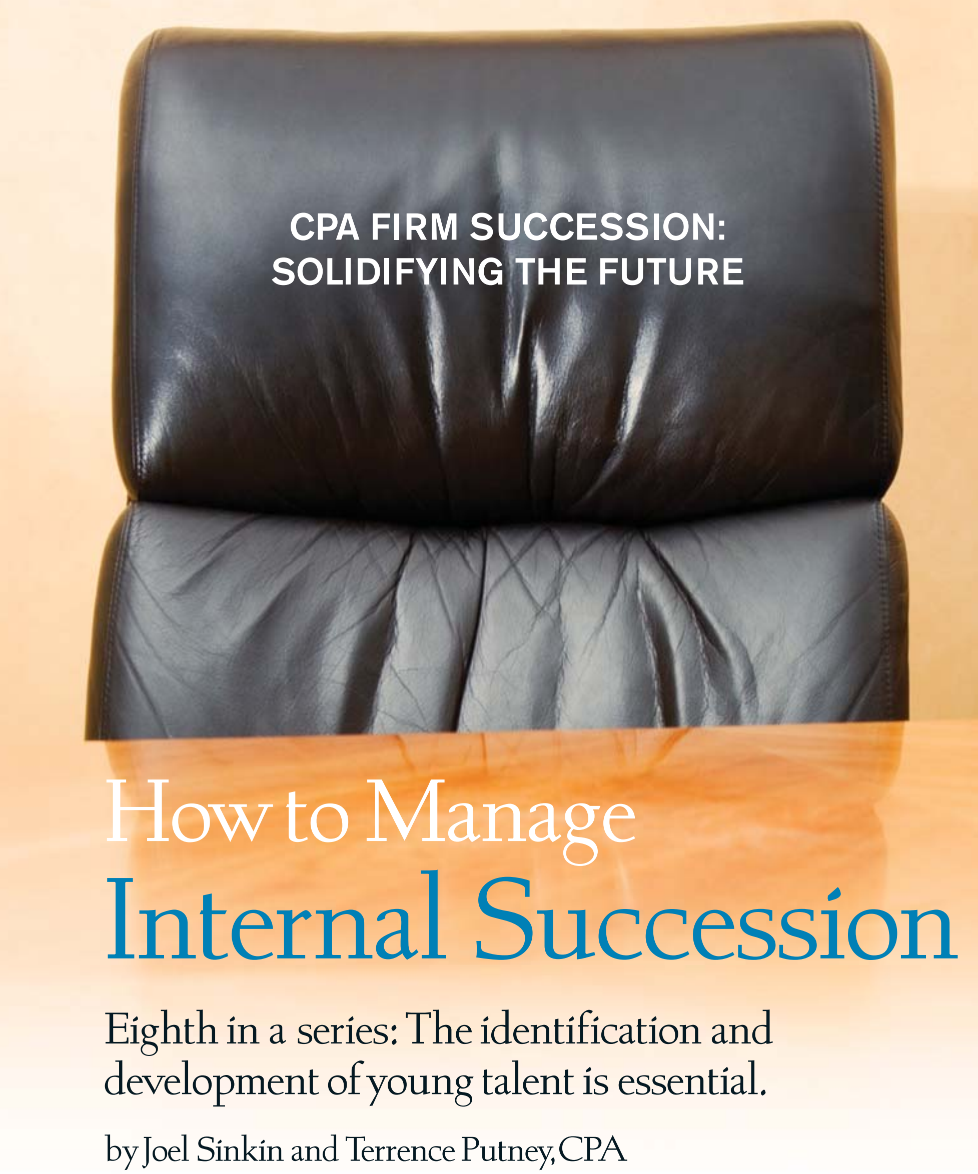

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CPA FIRM SUCCESSION: SOLIDIFYING THE FUTURE

How to Manage Internal Succession

Eighth in a series: The identification and development of young talent is essential.

by Joel Sinkin and Terrence Putney, CPA

The success of most accounting firm succession plans rests on the firm's ability to develop young talent into owners capable of buying out retiring partners and carrying the firm into the future. Unfortunately, many firms have little or no talent ready to assume this role, and many of the firms that do have talented staff on board don't know how to convert them into owners.

About the Series

Powerful forces are transforming the accounting profession in the United States. The Baby Boomers are heading into their retirement years. Baby Boomer CPAs are in charge of most U.S. accounting firms, and most of those firms don't have a signed succession plan or practice-continuation agreement in place.

The *JofA* is presenting a succession series designed to help accountants navigate the new landscape of succession and mergers. This month's installment, the eighth in the series, explains what firms need to do to implement a successful internal succession plan.

This inability to find or recognize young talent who can take the place of retiring owners is the main reason so many firms have to sell to an outsider to finance partner retirements. Some firms, however, can manage an internal succession. How can a firm assess and create its internal succession readiness? This article examines the process.

Perform Succession Triage on Your Firm

A successful internal succession plan is usually determined by the firm's ability to at least *maintain* its level of business following the transition of an owner. There are three key things to focus on when assessing the risk associated with transition. The first two, *timing* and *client loyalty*, were discussed in detail in the second article of this series (see "The Long Goodbye," Aug. 2013, page 36).

The third issue is *replacement* of retiring partners. How do firms replace a retiring partner's role? Sometimes they can allocate the retiring partner's duties to other partners in the firm. As an example, a partner in a five-partner firm is managing a $750,000 general book of business. The remaining partners believe they can allocate the clients among the existing partner team because they all have the capacity to take on extra work. The billable hours for the retiring partner will need to be replaced. However, that can be done across all levels of the firm by hiring two more staff members. A new partner does not need to be added to the team to replace the retiring partner. This is called *role reallocation*.

In contrast, firms may lack the necessary capacity in their partner group and need to bring on a new partner to take over the responsibilities of a retiring partner. This may be due to a lack of the necessary capacity at the partner level to assume all the responsibilities left behind. Or the retiring partner may have special technical skills or firm management responsibilities that are significant. This is called *role succession*, which means the firm needs to create succession for this partner's role.

The tool in Exhibit 1 can help in determining the timing and extent to which partners will have to be replaced.

Based on Exhibit 1, one could conclude the following for this example firm:

- The first partner who will be retiring does not appear to pose a significant succession threat. The firm believes it has the capacity within its current partner group and other resources and does not need to replace this person.

- The second set of retirements is potentially a critical situation. This firm needs to make sure it has new partners in place in time to properly transition these retiring partners' roles. Admitting new partners may be necessary as early as two to four years from now.

Remember that when the firm is replacing a partner in role succession, it should be replacing the role, not just the body.

Do You Have What It Will Take?

There are four major phases to executing internal succession:

- Obtain the necessary talent to develop internal successors.
- Develop the talent so it is ready to step into the role.
- Have a proper financial arrangement —both for admitting new partners and buying out retiring partners.
- Develop and execute a transition plan for a retiring partner's duties.

What constitutes the proper financial arrangement and how to develop and execute an effective transition plan will be addressed in the next two articles of this series.

Obtaining and Evaluating Talent

A significant number of firms have not developed a process to evaluate both the talent they already have on board and what additional talent they need to recruit. It is common to find a four-partner firm where two partners think Sally is ready for promotion, but the other two partners think she never will be ready. So the partners delay doing something about Sally indefinitely, and that stops the firm from looking for someone the partners can agree has what it takes.

It's critical that firms be able to assess partner candidates objectively so they (1) know what they should be looking for in the recruiting process, (2) can decide what gaps a candidate has in his or her skill set, (3) can institute a development plan to overcome shortcomings, and (4) can form agreement among management that a candidate is ready.

Clearly identifying in writing what it takes to be a successful partner can be a useful tool (see the sidebar, "Attributes of a Partner"). If the partners can't find anyone in the firm who meets those standards, they should keep the following in mind as they search outside the firm for potential partners:

- Be prepared to make a lucrative compensation offer to entice them.
- Paying what it takes can result in a temporary slip in profits, but experience shows that true talent will soon create enough additional value to overcome the investment.
- Make a solid plan and commitment for promotion to partner, including a timetable and benchmarks that need to be achieved, and then communicate the plan to the candidate.
- Understand that an experienced hire with near-partner talent may bring a different culture.

Developing Talent

Development of partner candidates should come in three categories. Remember to direct the development plan toward the areas where critical shortcomings have been identified.

- ***Generic competency development.*** This

Exhibit 1 Partner Succession Projection

Partner	1–3 years	4–7 years	>8 years
A	RR		
B		RS	
C		RS	
D			RR
E			RS

RR=Role Reallocation RS=Role Succession

Source: Joel Sinkin and Terrence Putney.

EXECUTIVE SUMMARY

- **Firms need to think of role replacement when planning for a partner retirement.** This means they need to replace the roles the partner handles, not just the position. In some cases, the remaining partners have the capacity to take on the departing partner's roles. In other situations, a new partner is needed.
- **There are four major phases to internal succession:** obtaining future partner talent, developing that talent, setting up a financial arrangement for admitting new partners and buying out retiring ones, and doing a transition plan for retiring partners' duties.
- **Firms should have a process to objectively assess partner candidates.** This is crucial for firms to know what they are looking for in future partners and to address gaps in those skill sets among potential partners. Such a process also lays the groundwork for partner agreement about who is ready for promotion to partner.
- **When searching outside the firm for potential partners,** firms should make lucrative compensation offers to lure candidates, craft a promotion plan with a timetable and benchmarks for advancement, and understand that hiring near-partner talent could change the firm's culture.
- **Development of partner candidates should come in three areas:** generic competency development (or CPE), culture-specific development, and mentoring.

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is also called continuing professional education, or CPE. Locate relevant classroom and third-party training in nontechnical skills such as practice development, supervision, and public speaking.

- ***Firm culture-specific development.*** This is also known as on-the-job training. Tailor increasingly challenging assignments to candidates to accelerate and test their progress.
- ***Mentoring.*** Constant communication and guidance are required to keep the momentum and focus on the development plan.

Many firms are now using nonequity-partner or income-partner status as a final proving ground before making the final decision on whether to admit a candidate as an equity partner. Firms that decide to go this route should have in mind how long the candidate will have that status and what he or she needs to accomplish before the final promotion. If the candidate is truly capable of being a full partner in the firm, a two- or three-year period as an income partner may be adequate.

Plan B

If firms don't have the time to develop talent internally and can't find the right person with near-partner talent to hire, they should consider using a merger or acquisition as a quick fix. As has been noted extensively in this series, many merger opportunities in today's market come with the need to solve another firm's succession problem. ❖

Attributes of a Partner

- *Leadership:* Provides guidance and is a role model for other partners and staff to achieve the firm's goals.
- *Client management:* Can manage an adequate number of client relationships profitably and effectively, and clients see the person as their trusted adviser.
- *Personal productivity:* Is personally productive in supplying services to clients and has a strong work ethic.
- *Growth:* Is able to develop new client relationships and expand services to existing clients.
- *Firm management:* Participates in the overall management of the firm and is a good businessperson.
- *Technical skills:* Has developed the technical skills necessary to provide exemplary service to clients and is known as an expert in a valuable service area.
- *Teamwork:* Puts the firm's interests ahead of his or her own and promotes a team attitude.
- *Staff development:* Assists in recruiting new talent and developing staff and is seen as a mentor to others in the firm.
- *Community involvement:* Is the face of the firm in the community.
- *Professional involvement:* Is involved in the profession outside the firm.
- *Passionate:* Has unwavering loyalty to the firm and has a passion for making the firm successful.
- *Communication skills:* Excels in written and spoken communication.
- *Personal investment:* Is on a constant journey to improve and sees every day as an opportunity to learn.

AICPA RESOURCES

JofA articles

CPA Firm Succession series

- Part 7: "Alternative Deal Structures for Succession," Jan. 2014, page 42
- Part 6: "Seven Steps to Closing a Succession Sale," Dec. 2013, page 48
- Part 5: "How to Value a CPA Firm for Sale," Nov. 2013, page 30
- Part 4: "A Two-Stage Solution to Succession Procrastination," Oct. 2013, page 40
- Part 3: "How to Select a Successor," Sept. 2013, page 40
- Part 2: "The Long Goodbye," Aug. 2013, page 36
- Part 1: "Mergers Emerge as Dominant Trend," July 2013, page 52

Other _JofA_ articles

- "Succession Planning: The Challenge of What's Next," Jan. 2013, page 44
- "Planning and Paying for Partner Retirements," April 2012, page 28
- "Traps for the Unwary in CPA Firm Mergers and Acquisitions," Aug. 2011, page 36

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