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Succession Planning for Accounting Firms

By John McCarthy

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Background

With the average age of members in practice across the different accountancy bodies in these islands at around 50+, practice succession has been a key issue facing firms of all sizes for some time. The burning questions that practitioners ask are how do we:

- fund the retirement of older partners?
- maintain the profitability of the practice?
- find younger hungry successors?
- make it attractive enough for those successors to become equity partners?

A lack of attention to succession issues has left many firms ill prepared for this question and many firms will have to resolve major financial problems in the meantime.

Firms need to be constantly on the lookout for younger qualified accountants to replace older partners in order to develop the business, court the next generation of clients and help fund the exit routes of retiring partners.

Planning

Attracting the right calibre of prospective partners has been very difficult in recent years but with the current economic climate, this may now be a little easier as the career choices available to newly qualified accountants are narrower than heretofore. This may not last forever, so there is at this moment a window of opportunity for firms within which to plan and recruit new partners.

An obstacle that needs to be overcome is been the fact that many young accountants simply do not want to make the financial commitment or take on the responsibilities and risks associated with partnership.

In addition firms need a much greater degree of specialist knowledge in prospective partners. Technical and compliance work is no longer a major growth area for most small and medium firms and will become even less significant in the future. Practitioners must therefore develop a much greater range of business advisory skills, for example, the Qualified Financial Adviser (QFA) qualification. They need to be prepared to diversify into new areas of corporate (e.g. corporate finance) and personal advice if they are to maintain business growth and profitability.

Lack of succession planning means that many retiring partners may face a bleak retirement. Reduced pension annuity values, insufficient funds within the practice to pay out goodwill or capital/current account balances quickly and lack of planning mean that many partners face the prospect of working into their 70s. The alternative is to accept a much reduced retirement income than they had anticipated.

When planning to fund an exit route for retiring partners it is most important that potential new partners are not put off because they may be burdened with prohibitive levels of debt. With careful planning younger partner can be brought on board, over time, in such a way that they are encouraged to make a positive contribution to the development and profitability of the practice.

Communication is key

One of the principal reasons why many practices have succession problems is because the subject is seldom discussed, and certainly not in any formal fashion. Yet it is vital that every partner in the practice not only has a very clear idea of what he or she wants in terms of retirement, but that this knowledge is communicated to the other partners and agreed with them. Without communication there can be no personal or financial planning. One way of achieving this is by having an away-day with an independent facilitator to tease out such issues and come up with an action plan.

Changing market

The changing market for accountancy services requires the appointment of new partners who

- will increase the skill pool within the firm
- who can take on the role of 'trusted adviser' to their clients
- who are entrepreneurial and will drive the business forward.

If firms don't nurture such talent in-house they must go into the marketplace to find the right people. They may be found within your own firm or at a Network meeting or perhaps at a conference or CPD course.

The partnership agreement should include a detailed retirement plan, including a set retirement age for partners.

All retirement and succession strategies should be flexible enough to allow for unexpected changes in circumstances over the years. Poorly drafted partnership agreements or ill thought out retirement plans could, and often do, threaten the continued viability of the practice.

If you don't know where you are going, you will end up somewhere else.

Preparation and planning

Funding retiring partners' exit routes can place an excessive financial burden on a practice that is not prepared. Not only must consideration be given to the source of the funds, but to ensuring that they are available in accordance with the planned retirement dates of individual partners. The partnership agreement should stipulate the repayment term of capital and interest accounts (and whether balances outstanding are interest bearing or not).

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Goodwill

Goodwill is another thorny subject, especially for founding partners who want to retire.

In the company context , the value of shares is (at least before any minority discount is applied) a reflection of the overall market worth of the business, which is likely to be measured as a multiple of turnover or profit as it is to be related to the value of the underlying assets. In the partnership world, however, the only way for this to be reflected is in the nebulous and increasingly rare concept of ‘goodwill’.

Although goodwill is a problem that may disappear eventually, for the vast majority of partners looking to retire in the next ten years or so, but who have purchased their partnerships, it is still a vital issue as they will expect to be paid out on retirement.

Growing businesses, principally owner-managed businesses, comprise the primary target market for the small and medium sector of the profession. These SME businesses look to their accountants to provide a wider range of services beyond mere compliance advice.

Business planning, cash flow forecasting, coping with the recession, managing growth, raising finance, profit improvement, tax planning, retirement planning, pensions and investments and mergers and acquisitions are just some of the skills that firms will need to provide in order to maintain profits and fees in the practice.

Moving from compliance to advisory

With the emphasis moving from compliance to advisory (non-audit) work there is a growing trend for some practices to create specialist departments. Essentially, this involves separating compliance (typically audit) and non-compliance work by creating a separate company to handle all non-audit aspects of the firm’s activities. The partnership continues to provide audit services. This helps improve efficiency, and creates a business with value that provides dividends for shareholders or which can be viewed as a saleable asset to create an exit route.

Firms, in order to survive and thrive must create a practice structure that will continue to effectively ‘find and mind’ clients and improve profitability through effective retirement and succession planning.

Profits

A significant part of the growth strategy must be directed at ensuring that the firm is growing in the right direction rather than simply accepting growth for its own sake. Once a critical mass has been achieved there is every opportunity for greater selectivity in taking on new business, but unfortunately many firms have an inability to turn away any potential client – even those that do not fit in with the firm’s growth strategy. The result is that, although the firm may grow in size its profitability may actually be reduced.

Firms also need to know exactly where their profits are coming from in order to both identify strengths and weaknesses within the client base and to plan the production of work. Using the rules of the Pareto 80/20 analysis firms can analyse where the profits of the firm are derived, broken down by type of work and by client.

The growth of some of the most successful firms has been achieved without merger or acquisition but by natural organic means. The secret of their success lies in their attitude to the people who work in the practice, who are after all is said and done, their most vital asset.

Developing the existing partners, developing potential partners within the firm or appointing new partners is key to the firm's future success. The full utilisation of existing skills and the development of new ones should be applied to every partner and every member of the firm's staff.

The process of identifying the need for new skills within the firm is inextricably linked to the business planning process. Reviewing the firm's clients will highlight not only the areas in which the firm should be offering added value services, but the skills that need to be developed in order to do so. An effective performance management system will quickly identify those people who either have those skills or the potential to develop them. It will also identify where firms need to bring new talent into the practice; including new partners.

Conclusion

The key is to be objective about what the practice really needs and then find someone who meets those needs. Without exception, those firms that have achieved successful organic growth have done so because they have created a business of value, not only in terms of their financial worth, but also in terms of the value they offer to employees, business partners and clients at all levels.

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John is a regular speaker on practice management matters, succession planning, compliance and audit/accounting technical matters and is has extensive experience in the provision of technical and strategic support to practicing accountants throughout Ireland. He has spoken at seminars and conferences for Chartered Accountants Ireland, the Association of Chartered Certified Accountants, the Institute of Certified Public Accountants in Ireland and the Institute of Chartered Accountants of Scotland.