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## CPA FIRMS FACE CONSIDERABLE SUCCESSION CHALLENGES

*Firms struggle most with procrastination and  
lack of “bench strength”*

The CPA Consultants' Alliance

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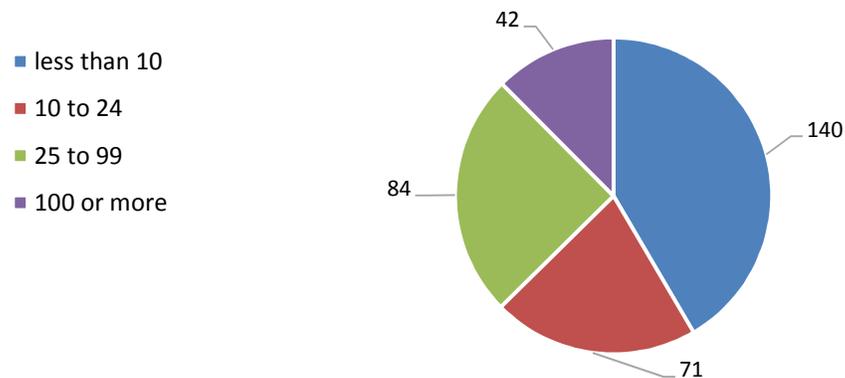


## CPA FIRMS FACE CONSIDERABLE SUCCESSION CHALLENGES

John Heywood's 1546 book of proverbs contains the earliest recording of the well-known phrase, "the shoemaker's children always go barefoot." Fast-forward a few centuries, and the same can be said about CPA firms and succession planning.

To uncover the reasons behind this modern "shoemaker's children" succession problem, [The CPA Consultants' Alliance](#) (CPACA) surveyed a cross-section of small, medium and large firms and analyzed responses from 337 participants. Nearly 85% of the respondents were owners or non-equity partners. The results were analyzed in conjunction with the data accumulated from the [2014 Rosenberg Survey](#) conducted by The Growth Partnership (TGP). Later in this article some of the member consultants of CPACA offer insights into how CPAs can address these issues in their firms.

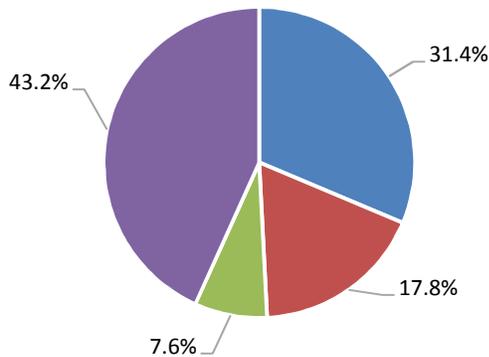
### What is the total number of employees, including owners, in your firm?



#### In summary form, the findings indicate firms:

- Are procrastinating or are in denial about succession.
- Lack significant "bench strength" around which to plan the transition, particularly at smaller firms.
- Do not have a systematic way to identify and develop talented staff into future partners.
- Lack plans for client transition.
- Are uncertain about their buy/sell arrangements.
- See a sale or merger as their most likely succession plan, particularly in the small firm respondents.

## How is your firm most likely to deal with the succession of your retiring partners?

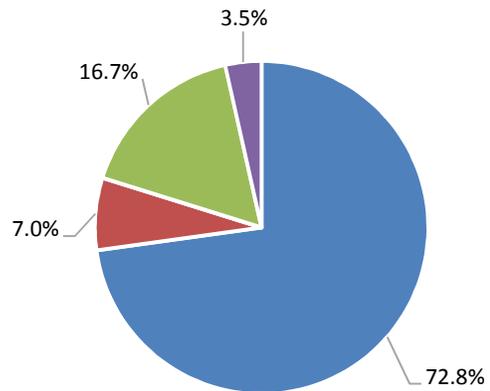


### Firms with fewer than 25 employees

- Internal Succession-We Will Hire and Develop Talent
- Internal Succession-We Do Not Need to Replace Any Partners in the Near Future
- Internal Succession-We Are Looking for Acquisitions to Strengthen Our Bench
- External Succession (Upstream-merger or Sale)

### Firms with 25 or more employees

- Internal Succession-We Will Hire and Develop Talent
- Internal Succession-We Do Not Need to Replace Any Partners in the Near Future
- Internal Succession-We Are Looking for Acquisitions to Strengthen Our Bench
- External Succession (Upstream-merger or Sale)



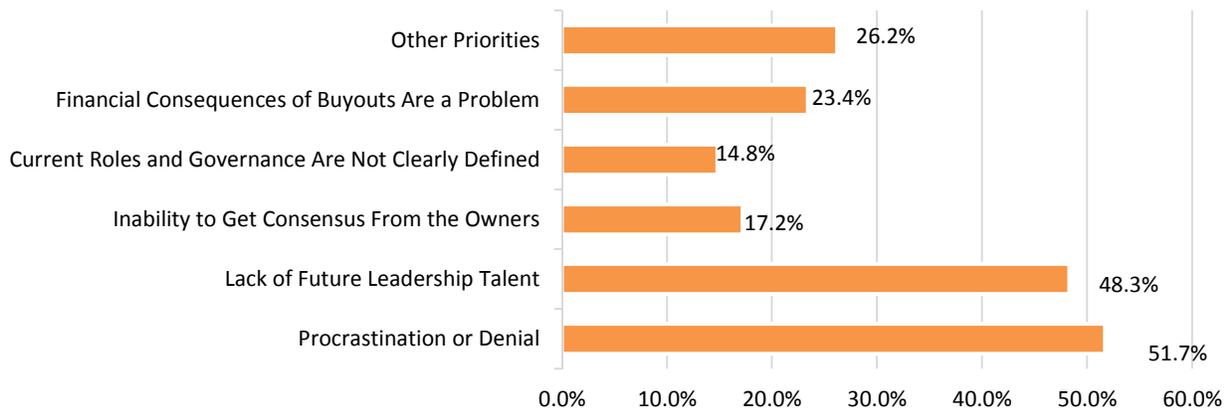
The number of partners facing retirement over the next few years continues to grow. In their November 2014, Journal of Accountancy article, "Succession Challenges for U.S. CPA Firms to Tackle," Jim Knafo and Anita Dennis stated, "About half of all U.S. CPA firms will likely lose at least one partner or principal to retirement in the next five years...." Data from the TGP's 2014 Rosenberg Survey goes deeper: Two-thirds of partners in all firms with more than \$2 million in fees are over the age of 50, and for firms under \$2 million, the percentage jumps to 73.3%. Eleven percent of partners in all multi-partner firms responding to the survey will retire within three years. About one out of every seven partners in responding firms of \$2 million to \$10 million in annual volume will be retiring in that timeframe. The average number of partners for responding firms that size is five.

Clearly the profession is facing a major time of transition. And, the issues around succession need to move to the front burner, especially at smaller firms. In the next section of this article, we'll summarize the CPACA survey findings, and then recommend action steps firms should take to prepare.

## SUMMARY OF SURVEY FINDINGS

An analysis of the survey responses by the CPACA developed five major takeaways, in both the way firm leaders feel about succession planning and how prepared they are for this critical transition:

### What do you think is the primary reason that firms struggle with succession planning (more than one answer is allowed)?

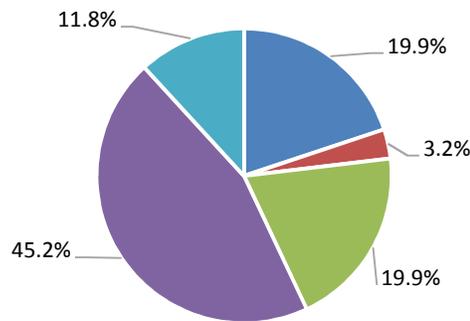


- **Procrastination and denial.** About 26% of respondents point to “other priorities” as the reason succession planning gets short shrift. But 51.7% point the finger of blame at procrastination or denial. One respondent put it this way, “Partners are more comfortable managing clients than facing the future. Very little vision and therefore one year leads to the next with little change yet partners get older each year.”
- **Lack of future leadership.** The larger the firm, the more likely its owners are to be confident about bench strength. However, even though 48% of responding partners in firms with 100-plus employees “definitely agree” their firm has adequate talent on hand, over half are not fully confident which is surprising given that these firms are within the largest in the U.S. Smaller firms are particularly vulnerable: Less than two-thirds of all responding partners say they have the right talent to replace retiring owners in the next five years, and one-third are not ready at all. As one respondent puts it, “Unfortunately we have not been able to attract sufficient talent that exhibits the desire and drive to be owners. We have been actively recruiting and training but things are still relatively uncertain.”
- **Lack of a system for developing talent.** Over 80% of surveyed partners in large firms and 51% of surveyed partners in midsize firms say they have a system in place for developing internal talent. Somewhat surprising is the 35% of all respondents who indicate their firms do not have a system in place. Thirteen percent of respondents in firms with fewer than 10 employees feel they do not need a system, presumably because they are looking to merge up, sell or close up shop when the time comes. CPACA member Rita Keller of Keller Advisors added, “Often partners hold-back on developing top performers because they are afraid of offending the “average” performers. They are avoiding confrontation.”

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- **No plan for client transition.** For optimum client retention, it is best to have a transition plan so the changeover in client service is effective. No ownership transition can be considered successful if most of the clients are not retained. According to the CPACA survey respondents, only 25% of firms have a client transition plan they are confident will work. The good news is that just over 40% of those who do not have a plan in place are working on one. And, of those that have a plan in place, 23% start the transition 3-4 years in advance of the owner's retirement.

**Does your firm have a system in place to identify partner level talent and develop them into future partners?**

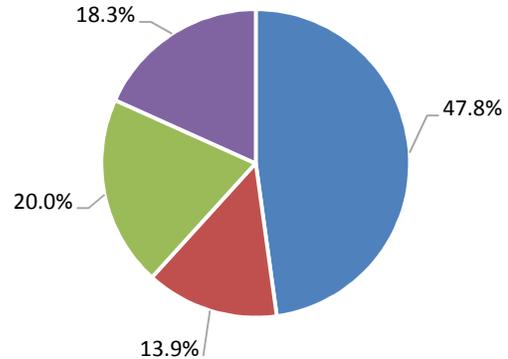


**Firms with fewer than 25 employees**

- Yes, we have a system and I am somewhat familiar with it
- Yes, we have a system but I am not familiar with it
- We are working on developing a system
- We do not have a system
- We do not feel we need a system

**Firms with 25 or more employees**

- Yes, we have a system and I am somewhat familiar with it
- Yes, we have a system but I am not familiar with it
- We are working on developing a system
- We do not have a system

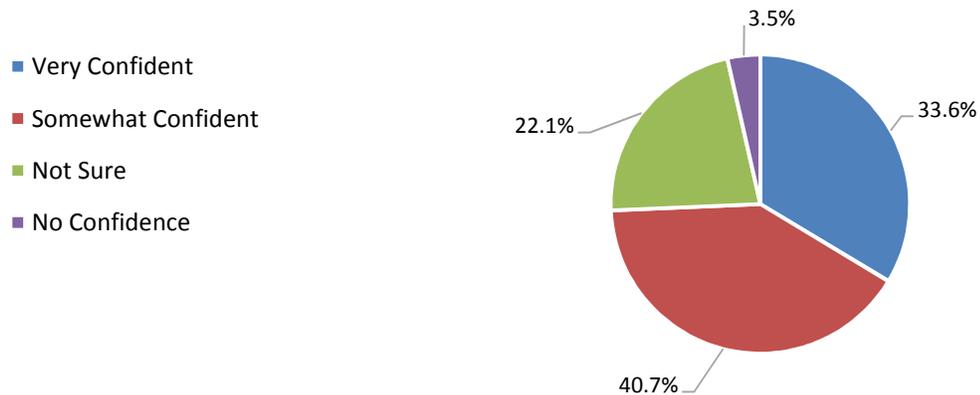


- **An unclear buy/sell situation.** Too many people, at firms of all sizes, aren't comfortable with how their ownership agreement handles the buyout of retiring owners, admission of new ones or the timing of either action. In fact, nearly 25% of the large firm respondents don't know what their agreement says, and the same is true of 50% of small firm owners. And, more than 75% of all firm respondents lack complete confidence they can handle future partner retirement obligations and nearly 40% either aren't sure or have no confidence at all.
- **Selling or merging is the plan.** Almost half of the respondents in firms with fewer than 10 employees and 20% of respondents in firms with 10 to 24 employees believe they will sell or merge-upstream to manage succession of their retiring partners. This response rate supports the increasing rate of mergers within the profession which are often driven by succession needs on the part of the selling or acquired firm. The data in the survey supports the conclusion that for many firms, an external solution feels like the only option

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either because their firm does not have the ability to create the resources necessary for internal succession or the partners lack confidence the resources they have will be a reliable solution.

### Are you confident your firm can manage the financial impact of future partner retirement obligations?



One very telling comment from a medium-size firm survey respondent seems to sum up the sentiment of many: “We are providing an excellent succession plan for retirement minded sole practitioners, but don’t have one for ourselves. We realize it is an issue, but have to put something down on paper first and see if the numbers work. That is where we are.”

The Rosenberg Survey provides additional data on the status of owner agreements in many firms. Twelve percent of all multi-partner firms responding to the Rosenberg Survey do not have a signed owner agreement. As a subgroup thirty-four percent of multi-partner firms under \$2 million in annual fees do not have a signed agreement. Of the firms responding that have a signed agreement, 19% do not specify in the agreement any provisions for making retirement payments. As another subgroup one-third of firms with two to four partners responding have a signed agreement that does not include provisions for retirement payments. “This all adds up to a lot of uncertainty,” says Charles Hylan, shareholder from TGP responsible for The Rosenberg Survey. Hylan continues, “As we talk with young partners and senior managers from responding firms we are finding they are very uncomfortable with the lack of clarity around succession issues...the void left by retiring partners, the lack of partner potential and no retirement provisions within partner agreements. Firms really need to account for each of the succession variables if they want their firms to continue into the future.”

## SOLUTION: PLANNING THE WAY FORWARD

Based on the survey findings, there are several action steps that firms need to take sooner rather than later:

- **Be realistic about the effort needed to properly plan for and manage successful succession.** One survey respondent indicated “The current ‘managing partner’ (owner) is in denial about what will be necessary to transition the firm to the next generation or if that is truly his intention.” Partners have to be willing to make securing the firm’s future via succession a top priority even if that requires a compromise with their personal goals and desires. CPACA member Dustin Hostetler, shareholder of Boomer Consulting adds, “There is a well-known business meme that reads from a CFO to the CEO ‘What if we invest in our people and they leave?’ and the response from the CEO to the CFO is ‘What if we don’t, and they stay?’. Firms need to challenge the traditional mindset of waiting to develop their people until they reach a certain level and instead realize that development should start from day one. The best talent won’t stick around if there isn’t ample opportunity for development - and firms will be left with mediocre leadership at middle levels of the firm well into the future.”
- **Get agreement on the firm’s direction.** It is essential to have everyone on the same page when it comes to the future of the firm. Ask your partners the following questions: Who is retiring and when? Do we continue to grow the firm’s pool of future leaders internally in order to sustain it? If we don’t believe this is possible, do we feel that an upstream merger is our eventual outcome? If your partners believe that an upstream merger is likely to be in your future, researching your options in this area may be prudent now while the market for acquisition is thriving and the firm is performing well.
- **Invest in next generation development.** A telling comment from a responding partner was “I believe that most firms are having trouble with their succession plan because they are not willing to commit to specific criteria for eligibility for partner, communicate it clearly to their staff and then stick to their policies.” Developing promising staff members into managers capable of becoming partners takes time and a willingness to invest beyond the bare minimum CPE needed to maintain licensure. Future leaders need leadership development, including project management, supervision, practice economics and “soft skills” such as communication, motivation and practice development.
- **Develop a path to partnership that motivates staff.** One reason the profession often loses top talent to the corporate world is the path to partnership at many firms is unclear and too distant. The Knafo/Dennis article referred to a 2014 survey conducted by the Global Accounting Alliance that found 54% of employees in surveyed firms strongly or at least somewhat agreed they would be more likely to stay with their firms if they knew they would be offered ownership in the future. However, only 30% of employees said that their firm owners had discussed ownership possibilities with them.
- **Get clarity around client transition.** Studies by CCH and others have shown that at any given time about one-third of all clients are considering moving their business elsewhere. And a client faced with their primary service provider’s retirement is particularly vulnerable. For best results, the transition from one member of the firm to another needs to be a seamless non-event that occurs over time. “Client transition, although uncomfortable, must be made a priority for the health of the organization. Clarity around the expectations for when client transitions should begin and regular check in meetings will make the process go much more smoothly,” says CPACA member Angie Grissom, President of The Rainmaker Companies.
- **Help partners let go.** It is best to consider at least a two-year transition, during which the internal successor is in place while the retiring owner participates in the transition process. Recognize that it is often difficult for partners, who by nature are used to controlling things, to let another person take over. Strong leadership is often required to manage partners reluctant to transition clients as they near

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retirement. A trend in the profession is placing financial consequences on the buyouts of partners that fail to follow the plan or financial incentives for those that do.

- **Consider better compensation systems for existing and newly admitted owners.** In the survey, less than 25% of participants said they were confident the firm could handle the future retirement obligations of its partners. “We find many younger partners in firms we work with are not confident their firm can afford to pay for all the partner retirements they know are pending,” says CPACA President Terrence Putney, CEO of Transition Advisors. “A financial model that analyzes the relationship between a retired owner’s compensation, which is the capital available to fund the obligation, and the cost of replacing and retiring an owner will disclose if a problem truly exists. Too few firms have gone through that modeling exercise.”

To sum up, it’s time to give this particular shoemaker’s children problem the boot. Owners must stop procrastinating and deal with issues that are easy to put off because without an effective and well-thought out succession plan, too much is left to chance. Planning is the secret to ensuring an outcome that’s positive for everyone concerned — current ownership, future ownership and the firm’s clients.

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#### OTHER RESOURCES AVAILABLE FROM CPA CONSULTANTS’ ALLIANCE

We invite you to visit our website, [www.cpaconsultantsalliance.com](http://www.cpaconsultantsalliance.com) to access two other survey-based studies we have conducted. [CPA Firm Leadership: Communication Drives New Possibilities](#) was released in 2012. [Measuring Happiness at Work: How Firms Can Win With a Happy Culture](#) was released in 2014. You may subscribe to our weekly blogs there as well. Follow us on [Twitter](#) and connect with us on [LinkedIn](#).

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