Succession Challenges for U.S. CPA Firms to Tackle

Global Accounting Alliance survey shows the need for practice-continuation planning is reaching a critical point.

by Jim Knafo, CPA, CGMA, and Anita Dennis

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About half of all U.S. CPA firms will likely lose at least one partner or principal to retirement in the next five years, the AICPA learned as part of a worldwide survey conducted in May 2014 by the Global Accounting Alliance (GAA), which is made up of 11 of the world's leading accounting institutes. As U.S. firms look to fill the gaps retiring Baby Boomers are leaving, they must tackle five major challenges.

The survey identified these challenges:

- Looming transition needs.
- Roadblocks on the path to leadership.
- Challenges for sole practitioners.
- Time constraints that impede planning.
- Problems with plan implementation.

The AICPA, which is a GAA member, participated in the GAA succession planning survey to help identify the readiness of accountants to address succession issues and to determine what services might help them achieve their continuity planning goals. The GAA survey results reiterated results of the succession survey the AICPA Private Companies Practice Section (PCPS) conducted two years ago. Both surveys found that CPAs know succession planning is important, but not enough take steps to institute a formal plan. The need for succession planning is particularly pressing among sole proprietors.

"Robust succession strategies are critical to the future success of the accounting profession worldwide," said AICPA President and CEO Barry Melancon, CPA, CGMA. "We have a stewardship responsibility to instill professional pride and knowledge in our future leaders. We also want to provide the information and resources firms need to make productive future transitions. This survey is a valuable tool in determining where we stand in our efforts."

Five Succession Challenges

1. Firms Face Imminent Succession Issues

Fifty-two percent of firm managers/owners in multipartner firms were aware of partners or principals who were expected to retire within the next five years, making succession planning a pressing issue for the majority of practices.

When one partner leaves, it's likely the firm will need new leadership to take on his or her responsibilities. The good news is that 78% of surveyed managers/owners said their firms had identified staff or other suitable people who could be prospective owners. However, only 68% had actually discussed ownership opportunities with one or more staff, and even fewer (53%) offered ownership partner training to one or more staff. (See Exhibit 1 for multipartner firms' top exit strategy considerations.)

Exhibit 1 Exit Strategy Considerations Among Multipartner Firms

The GAA survey asked which exit strategies managers/owners in multipartner firms might or will consider using:

- Selling their share of the business to other partners in the firm (82%).
- Not fully retiring but remaining a consultant to the firm after transferring ownership (77%).
- Merging with another practice before retirement (49%).
- Selling the entire firm (38%).
- Selling their share of the business to someone in the firm who is not a partner (35%).
- Selling their share of the business to an external partner (30%).

2. The Path to Leadership May Not Be Clear

The 2011 PCPS Top Talent Study, which measured the aspirations and expectations of firms' most promising staff, showed that career growth opportunities are an important element in attracting and retaining the highest-quality professionals. The GAA survey found that firms may need to do a better job of clarifying future career paths and opportunities. Even though 59% of the CPA firm employees surveyed said their firms have formal processes for admitting new owners, one-quarter didn't know if their firm had a formal process. Among firms that did have a formal process, 78% of employees said their firms generally adhered to it, while the remainder did not know.

"The lack of clear career growth opportunities and failure to provide a formal road to leadership could make it more difficult for firms to hire top graduates or to hold on to ambitious professionals," said Mark Koziel, CPA, CGMA, AICPA vice president–Firm Services & Global Alliances.

In fact, the GAA survey found that more than half of employees in surveyed firms agreed (strongly or somewhat) that they would be more likely to stay with their firms if they knew they would be offered ownership in the future (54%). But only 30% of employees said that their firm owners had discussed ownership possibilities with them. Young professionals were also clearly open to opportunities outside their firms. Twenty-six percent expressed an interest in starting their own practices, and 22% said they would consider becoming an owner in another firm.

Firms should be aware that many employees would like to step up to leadership in the relative near term. Asked to look ahead eight years, 39% of firm employees were hoping for an ownership position in their firm, while 14% sought a more senior position but not at an ownership level. Twelve percent were planning to leave public practice, and only 6% wanted to stay in their current position. Firms may have a competitive advantage in retention and recruitment if they clearly delineate the path to ownership and also clarify career opportunities for those who want career challenges but may not aspire to ownership.

3. Sole Owners Face an Uncertain Future

Among sole practitioners or owners, 60% expected to continue working past age 65, with 28% planning to stay on the job up to age 70. That's not to say they had not thought ahead to retirement. Only 3% had failed to do so, which may mean the other 97% would be interested in receiving information on succession planning from the AICPA. (See Exhibit 2 for what sole practitioners identified as their top exit strategies.)

Since a future sale was one of the projected options, it wasn't surprising that when asked what information would be "very useful" to them, the most popular choices were:

- Valuing a CPA firm (62%).
- Buying and selling a CPA firm (51%).
- Preparing a firm for sale (48%).

Among all respondents, there was also clear recognition that they needed planning help. Forty-five percent said information on developing a business continuity plan would be very useful, and 40% said the same about information on the details of a business succession plan. Help with choosing an exit strategy also appealed to 40%.

Exhibit 2 Exit Strategies for Sole Practitioners

The GAA survey cited seven possible exit strategy choices and asked sole practitioners which ones they might or will consider:

- Not fully retiring but remaining a consultant to the firm after transferring ownership to a successor (82%).
- Selling the business as a going concern (75%).
- Merging with another practice before retirement (69%).
- Winding up the business and selling the client list (57%).
- Assisting clients to transition to another firm (52%).
- Developing a nonfamily successor internally (49%).
- Developing a family member successor internally (28%).

EXECUTIVE SUMMARY

- **U.S. CPA firms face imminent succession issues** because about half of them are likely to lose at least one partner or principal to retirement in the next five years and many firms have not done a good job attracting and retaining talent suitable to fill the leadership gap.
- **Sole practitioners are aware they need planning help.** The results the AICPA received as part of the Global Accounting Alliance succession survey suggest seven potential exit strategies for sole practitioners.
- **Multiowner firms and sole practitioners** are asking for help to devise business continuity and succession plans, but challenges hobble implementation of those plans.

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However, while CPAs signaled an interest in mergers or acquisitions, few reported actually taking steps toward transition to new owners or leadership. For example, while 75% of sole practitioners said they might or will consider selling their business, only 35% had actually discussed a sale of the business or client list to an outside firm.

And although roughly half said they would consider internal succession, it may not be a realistic solution. The GAA survey found that the two most common types of staff employed by sole practitioners are administrative or support staff (58%) and accounting technicians, bookkeepers, and nondesignated accountants (55%). (Only 42% said they had a CPA on their payroll.) Eighteen percent said they had no staff. Further, only 22% had either identified staff who could be potential owners or discussed ownership opportunities with staff.

"For many sole practitioners and partners in small firms, their share in the business is their most valuable asset," said Carl Peterson, AICPA vice president–Small Firms. "To secure their retirement, it's critical to plan well ahead to ensure they get the most value from this important asset and that they can choose a career transition that meets their needs and expectations." For example, since small firm owners have very strong relationships with clients, they should allow ample time to familiarize them with new owners, he noted.

4. Time Constraints Impede Planning

"What is the best time to begin to tackle succession planning? The simple answer is that you should begin the day you form your firm," according to Joel L. Sinkin and Terrence E. Putney in their book, *CPA Firm Mergers & Acquisitions: How to Buy a Firm, How to Sell a Firm, and How to Make the Best Deal* (see also "Pricing Issues for Midsize and Large Firm Sales," page 50 in this issue).

While a formal plan can be the foundation for a successful transition to new leadership or ownership, the majority of firms don't have one. Only 37% of multipartner firms had a written or formal business succession plan. Among those that did have plans, 79% have shared information about it internally or implemented it within their firm. Slightly fewer (33%) said their firms had a written or formal business continuity plan to ensure continuity of service to their clients if key people in the business were unable to maintain client service.

Given this lack of planning, the AICPA appears to have an opportunity to exert positive influence on firms that recognize the value of thinking ahead but need resources or information that smooth the process. Roughly one-third (35%) of managers/owners have turned to a non-AICPA source for advice on succession or continuity planning topics compared with 26% who have relied on AICPA resources. When asked what these plans should address, partners or owners from multiowner firms listed issues that included a client retention plan in the event of succession (87%), an exit strategy for current principals/partners/business owners (87%), and dealing with succession issues in the event of incapacity or death (83%).

Although firm leaders were aware of the need to plan, many found it difficult because of the many demands on their time. Among multiowner firms, 27% acknowledged the benefits of planning, but these partners said they hadn't found the time to develop a plan (24%) or didn't know where to start (4%). Only about

The vast majority of sole practitioners clearly have not addressed succession or continuity concerns.

Succession Planning Tips

The AICPA Private Companies Practice Section conducted surveys that addressed the unique succession issues faced by multiowner firms (available at tinyurl.com/qzhabug) and sole proprietors (available at tinyurl.com/ptyegnk). The reports and *JofA* articles from Joel Sinkin and Terrence Putney, CPA, (see AICPA Resources) contained suggestions for how to confront these challenges.

To prepare for a change in leadership, the research suggests that multiowner firms:

- Write a formal plan that includes details on client transition, mandatory retirement rights, responsibilities and limitations of retired partners, training for future leaders, and projections for the firm's selling price.
- Research your exit strategy options, determine transfer of a retiring partner's ownership interests, and seek an expert adviser.
- Identify and train talent to develop inside successors.
- Examine your client data and evaluate your rates. Upgrading your client list makes the firm more attractive to buyers.

The research includes these tips for sole practitioners:

- Implement a practice-continuation agreement to ensure clients' needs are taken care of in the event of the practitioner's disability or death.
- Allow technology to take care of low-value, routine functions and free up time for clients and succession planning.
- Include an opt-out clause in any merger or acquisition agreement.
- Focus on top clients and strengthen your relationship with them.

one-quarter (26%) believed that succession issues were adequately addressed in their partnership agreements.

Sole practitioners were more likely to have a formal business continuity plan (12%) than a business succession plan (2%), but the vast majority of these CPAs clearly have not addressed succession or continuity concerns. Once again, time constraints were an issue. Twenty-seven percent of sole practitioners said the main obstacle to succession planning was the time involved, while 22% didn't think planning was relevant to their business. Another 13% had no idea how to get started, and the same percentage had not yet thought of it.

When it came to continuity planning, 75% of sole practitioners with formal continuity plans were counting on professional staff to handle the transition. This underscores the need to introduce staff to management responsibilities, especially in firms where one strong leader has allowed staff members few opportunities to try out their leadership skills. One-half had left instructions on their desired transition to their executor, 38% had granted a power of attorney to a non-CPA, and 13% had granted a power of attorney to a CPA. Only 13% had a formal, written practice-continuation agreement with another firm.

Exhibit 3 Top 10 Implementation Challenges

- Challenges in replacing the skills of departing owners (50%).
- Transitioning clients from retiring partners/principals (41%).
- Partners' reluctance to relinquish work relationships (41%).
- Challenges in training/mentoring internal staff for partner/principal roles (40%).
- Reluctance of partners/principals to retire (24%).
- Challenges in funding payments to exiting partners/principals (20%).
- Loss of leadership (17%).
- Remaining owners' lack of shared vision on business goals/governance/direction (15%).
- Ownership conflict—partners taking large compensation packages with less workload (14%).
- Dealing with the unexpected (14%).

When constructing their business succession or continuity plans, the top concerns of sole practitioners were:

- Succession issues in the event of incapacity or death (72%).
- Client retention plans (71%).
- Exit strategies (68%).

These firms could likely benefit from information on succession planning. In fact, when asked if they thought their plans would be adequate to help them achieve their exit goals, 100% of sole practitioners were uncertain.

5. Problems With Plan Implementation

Even those firms that have done their planning may still face challenges with implementation. A significant majority (83%) of managers/owners reported at least one challenge when implementing their business succession plan, while 51% faced issues when putting their plan together. (See Exhibit 3 for a list of top implementation challenges.) ❖

Who Responded to the Survey?

The U.S. portion of the GAA survey received 634 responses. The majority of respondents, who were AICPA members in public practice, worked in firms with multiple owners (88%). Most of the respondents in multi-owner firms held leadership positions—60% were either partners/owners or managing partners/managing owners. Ten percent of respondents were sole practitioners. Another 30% were employees or consultants at CPA firms.

Ninety-three percent of the managers/owners in multipartner firms employ at least one CPA. Their firms also include administrative/support staff (89%) and accounting technicians, bookkeepers, and nondesignated accountants (83%).

The AICPA's *2013 Trends in the Supply of Accounting Graduates and the Demand for Public Accounting Recruits* report showed a gap between male and female leaders in firms, with women representing 44% of accounting employees at CPA firms but only 19% of the partners. The GAA survey also revealed a gender difference, with noticeably fewer women who were owners/partners (38% of male respondents vs. 28% of females) or managing owner or partner (29% vs. 17%). Women were more likely to serve as employees (46% of women vs. 20% of men).

AICPA RESOURCES

JofA articles

- "Managing Risk in a CPA Firm Merger or Acquisition," May 2014, page 16
- "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

CPA Firm Succession series

- "Part 8: How to Manage Internal Succession," Feb. 2014, page 38
- "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 3: How to Select a Successor," Sept. 2013, page 40
- "Part 2: The Long Goodbye," Aug. 2013, page 36

Use **journalofaccountancy.com** to find past articles. In the search box, click "Open Advanced Search" and then search by title.

Publications

- *CPA Firm Mergers & Acquisitions: How to Buy a Firm, How to Sell a Firm, and How to Make the Best Deal* (#PPM1304P, paperback; #PPM1304E, ebook)
- *Management of an Accounting Practice Handbook* (#090407, loose-leaf; and #MAP-XX, one-year online subscription)
- *Securing the Future: Volume 1: Building Your Firm's Succession Plan*; *Volume 2: Implementing Your Firm's Succession Plan* (#PPM1307HI, volume 1 & 2 set, paperback; #PPM1305P, volume 1, paperback; #PPM1305E, volume 1, ebook; #PPM1306P, volume 2, paperback; and #PPM1306D, volume 2, online access)

CPE self-study

- Making Key Financial Decisions: Practical Tools and Techniques for Making Your Key Financial Decisions (#733835, text)

For more information or to make a purchase, go to **cpa2biz.com** or call the Institute at 888-777-7077.

Survey reports

- *The 2011 PCPS Top Talent Study*, **tinyurl.com/p2qw7n7**
- *2012 PCPS Succession Survey* (sole proprietors), **tinyurl.com/ptyegnk**; and *2012 PCPS Succession Survey* (multi-owner firms), **tinyurl.com/qzhabug**
- *2013 Trends in the Supply of Accounting Graduates and the Demand for Public Accounting Recruits*, **tinyurl.com/ovz3ntx**

Private Companies Practice Section and Succession Planning Resource Center

The Private Companies Practice Section (PCPS) is a voluntary firm membership section for CPAs that provides member firms with targeted practice management tools and resources, including the Succession Planning Resource Center, as well as a strong, collective voice within the CPA profession. Visit the PCPS Firm Practice Center at **aicpa.org/PCPS**. The Succession Planning Resource Center is available at **tinyurl.com/oak3l4e**.