Public Practice E-News
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This electronic newsletter is prepared especially for public practitioners and is sent bi-monthly to members of the Puerto Rico Society of CPAs. This e-newsletter features regular commentary from TSCPA Member Bill Reeb, a CPA firm consultant based in Austin. For questions or comments concerning the articles featured in this issue, or to suggest future topics, please e-mail Reeb at bill@tscpa.net.

From the BILLiverse
In this article, Bill Reeb continues to review the common confusion surrounding one-firm concept partner compensation. The previous article in this series looked at the goal-setting process, including which person or group should orchestrate which parts of it. He concludes his discussion on this topic by walking through the financial side of assessing goal accomplishment and how it works when considering actual firm profits. He covers statistics from the Succession Institute's latest survey on succession planning and uses a case study approach to assist readers in understanding the roles and responsibilities of those who should be involved in the process. He also provides insight as to how to approach the final assessment and calculations to create a transparent process for all of the partners. There will be one approach or another that will seem the most fair to the partners in the firm and that is the approach that should be taken.
Read Reeb's commentary
Link to article

It's a Great Time to Own a CPA Firm
CPA firm revenues are surging, according to the 18th annual Rosenberg MAP Survey. It is the strongest expansion in almost a decade. The advances are being fueled mostly by organic growth, with the merger frenzy showing no signs of slowing down.
Get the details in this article from Rick Telberg
Link to article

Five Trends Shaping the Future of Accounting Marketing
Business development and marketing strategies used for many years are losing their effectiveness and fierce, new competitors are experiencing success. Firm leaders who understand the forces shaping the future of the professional services marketplace will have an advantage. This article covers five important trends that are shaping the future of accounting marketing.
Read the article
http://www.accountingweb.com/practice/practice-excellence/5-trends-shaping-the-future-of-accounting-marketing

Best Types of Market Research for Accounting Firms
Market research can pay off for professional services firms. It has been shown that those firms conducting systematic research on target client groups are more profitable and grow much faster. The question becomes what types of market research should be used since there are various types available.
Lee Frederiksen takes a closer look

http://www.accountingweb.com/practice/practice-excellence/best-types-of-market-research-for-accounting-firms

Find the Answers to Your Practice Management Questions

What is the best practice management direction for your firm? Should you consider value billing? Is your revenue comparable to similar-sized firms in your area? The 2016 AICPA PCPS/CPA.com National Management of an Accounting Practice (MAP) Survey, the profession's largest practice management benchmarking poll, has the answers to these and other questions.
Learn more
http://blog.aicpa.org/2016/12/find-the-answers-to-your-practice-management-questions.html#sthash.2XAvrGhW.dpbs

Deflecting Clients' Requests for Defense and Indemnity
Client requests for defense and indemnity by their CPA firm are on the rise. Why should CPA firms be concerned? Requests for such clauses are unnecessary and unfair, and they are unenforceable in some cases.
Get the details
http://www.journalofaccountancy.com/news/2016/dec/client-requests-for-defense-and-indemnity.html

How to Develop a Path to Leadership for Millennials
Particularly in the accounting profession, the effect of the millennial age group in the workforce will be profound. To effectively become leaders in the profession, they will need to integrate strategy and higher-level thinking into how they approach their careers and business. Millennial professionals require tangible and action-oriented connections between existing quantitative skills and strategic thinking.
Learn more
http://www.accountingweb.com/practice/team/how-firms-can-develop-a-path-to-leadership-for-millennials

Filling Vital Support Roles
Employing a high-quality administrative staff is a major benefit for public accounting firms. In this article, support staff experts offer tips for hiring and retaining a strong administrative staff.
Cheryl Meyer takes a closer look
http://www.journalofaccountancy.com/issues/2016/dec/how-to-fill-vital-support-roles.html

Use Standard Terms to Build a Liability Shield
An engagement letter is only as effective as the understanding it creates with the client. Firms should add standard terms and conditions to all engagement letters to give the firm and the client the benefit of a single understanding addressing the key contractual elements of the relationship.
Learn more
http://www.journalofaccountancy.com/issues/2016/oct/cpa-engagement-letters-terms-and-conditions.html

One-Firm Concept Partner Compensation: Common Points of Confusion – Part 4

By Bill Reeb, CPA, CITP, CGMA

Previously, we reviewed the goal-setting process, including which person or group should orchestrate which parts of it. Now, we will conclude the discussion by walking through the financial side of assessing goal accomplishment and how it works when considering actual firm profits.

Let's start with some statistics from our latest Succession Planning survey, which we did in partnership with AICPA's PCPS. The following tables show information regarding compensation systems, broken down by size of firm (by full time equivalent [FTEs], which includes everyone, from administrative to staff to partner).

Answer	1-7.99 FTEs	8-15.99 FTEs	16-25.99 FTEs	26-50.99 FTEs	51-100.99 FTEs	101-200.99 FTEs	201 or more FTEs =
Open compensation system	81%	85%	84%	79%	59%	41%	38%
Closed compensation system	19%	15%	16%	21%	41%	59%	62%
Total	68	99	63	61	37	17	13

Answer	2016%
A guaranteed portion of their salary (or base pay) with an additional incentive component based on both subjective/qualitative criteria and objective/quantitative formulas in our compensation plan.	37%
Based only on objective/quantitative formulas in our compensation plan. Any money a partner receives during the year is simply a draw against that final calculation.	23%
Based on both subjective/qualitative criteria and objective/quantitative formulas in our compensation plan. Any money a partner receives during the year is simply a draw against that final calculation.	20%
A guaranteed portion of their salary (or base pay) with an additional incentive component based only on objective/quantitative criteria in our compensation plan.	20%
Total	100%

Answer	1-7.99 FTEs	8-15.99 FTEs	16-25.99 FTEs	26-50.99 FTEs	51-100.99 FTEs	101-200.99 FTEs	201 or more FTEs
The managing partner sets individualized goals for each partner based on the strategic plan AND has a discretionary compensation stick to hold partners accountable for achieving their goals.	5%	6%	16%	17%	32%	41%	42%
The managing partner does not set goals for each partner but HAS the discretionary ability to adjust partner pay.	44%	21%	29%	22%	19%	12%	8%
The managing partner sets individualized goals for each partner based on the strategic plan, but does NOT have the ability to hold partners accountable with discretionary compensation.	5%	9%	2%	12%	8%	6%	0%
The managing partner sets individualized goals for each partner based on his/her individual ideas and criteria (not based on the firm's strategic plan), but does NOT have the ability to hold partners accountable with discretionary compensation.	2%	1%	5%	3%	14%	0%	8%
The managing partner sets individualized goals for each partner based on his/her individual ideas and criteria (not based on the firm's strategic plan) AND has a discretionary compensation stick to hold partners accountable for achieving their goals.	5%	1%	0%	2%	8%	18%	8%
The managing partner does not set goals for each partner and has NO individual ability to adjust partner pay.	40%	62%	49%	43%	19%	24%	33%
Total	63	94	63	58	37	17	12

Looking at the three graphics above, you can conclude the following:

- Most compensation systems are open (meaning all partners know what all partners are paid), but the larger the firm, the more likely they use a closed compensation system. Open compensation systems generate more partner-to-partner comparison discussions, while closed compensations do not, since there is no data to discuss. Comparison can make some sense when everyone is familiar with the work, efforts and contributions of the other partners. But the more partners a firm has, and the less each partner knows about all of the others, the more dysfunctional and disruptive the comparison conversation becomes.
- The second table above shows that the most common model used for partner compensation is a guaranteed portion of partner salary (or base pay), together with an additional incentive component based on both subjective/qualitative criteria and objective/quantitative formulas in the compensation plan. While the breakdown was not included in this graphic, it shouldn't be a surprise that the larger the firm, the more likely this model is used. For example, this model is used about 60 percent of the time for firms with 50 FTEs or more. The smaller the firm, the higher the likelihood that partner pay is determined by objective metrics only and the larger the firm, the higher the

likelihood that partner pay is based on both objective and subjective, or quantitative and qualitative, metrics.

- When it comes to the managing partner's role in compensation, as you know from our prior installments in this series, we believe that he/she should be able to set individualized goals for each partner based on the strategic plan AND have a discretionary compensation stick to hold partners accountable for achieving their goals. The third table above shows that the percentage of firms using this approach is far too low. For example, 6 percent of firms with less than 16 FTEs use it. Even at firms with 100 or more FTEs only 41 percent to 42 percent are using it. Based on this table, it is easy to see why "lack of partner accountability or unity" has shown up consistently in the PCPS Top Issues Survey. Most firms don't give anyone the ability to hold the partners accountable to a plan or to set clear expectations identified in advance.

Now that we have considered these compensation system statistics, let's back up a little and start from the beginning. The first concept to discuss is base pay. Then we will discuss incentive pay. And then within incentive pay, we will cover two common variations. For simplicity of this potentially complicated discussion, we will start drilling down from the number we call budgeted expected pay (BEP).

BEP is pretty straightforward. It is that amount the firm budgets in the planning process, which is what they think each partner will earn, assuming normal expected performance. While this sounds simple, for many firms, this concept is unsettling. Why? Just looking at the table above, 43 percent of firms believe all pay to partners is just a draw against final profits. Because of this, they take the idea that "owners don't get paid until there are profits to share" to an extreme. We believe that all partners should make more than the people below them in the organizational hierarchy. And we totally understand, being entrepreneurs ourselves, that if there is not enough money to go around at the end of the day, the owners are the ones who get to eat the shortfall. But I can also tell you that any going concern that doesn't pay its partners as well or more than the highest paid employees doesn't have much of a future either. Why not be an employee if you can make more, have less responsibility and less liability than an owner?

While this is a conversation for another time, the point here is that there should be a total pay expectation that is budgeted for every partner, which is in excess of that paid to principal or managers. We will share later how to reconcile a budget shortfall, as well as reconciling profits in excess of expectations. To begin with, you need to set the right expectation. So, whether your firm utilizes a compensation system based on all objective (quantitative) measures, a combination of objective and subjective (qualitative) measures or some hybrid, the reality is that if the firm makes about the same in profits and a partner performs similarly this year to last year, he/she will make about the same amount of money this year as last year. The idea of starting the budgetary process with an identified BEP per partner is a logical way for a firm to create a realistic plan, as well as to identify potential hurdles that need to be overcome if partners want to improve their earnings in the coming year.

With that in mind, consider the following table.

Partner	Budgeted Expected Pay (Total)	Assumed Base Pay at an 80% Level	Assumed 100% Incentive Pay at a 20% level
Alpha	175,000	140,000	35,000
Bravo	350,000	280,000	70,000

Charlie	200,000	160,000	40,000
Delta	425,000	340,000	85,000
Echo	275,000	220,000	55,000
Totals	**1,425,000**	**1,140,000**	**285,000**

In this case, we set up a budget based on past typical earnings. If we earn the expected profits, and everyone performs at an expected normal, then each partner will make his/her BEP. If we don't meet budget, and partners perform at various levels over and under expectation (which is normal), then we will simply adjust partner pay based on performance to the amount we have actually earned (more on how that works later). The key to consider in our example is that BEP is comprised of a base salary (often called guaranteed salary) and incentive pay. In our case study for this article, we used an 80/20 ratio, but firms use every imaginable variation to this, based on what they think is best for them. This could just as easily be 70/30 or any other ratio a firm decides upon. What's important to understand for this case study is that some portion of pay is guaranteed (meaning you have earned that by coming to work every day and doing what you do) and the rest is earned based on what you actually accomplish during the year.

A point of confusion that usually arises here is "We don't have the money to pay out that level of pay every month of the year" or "We are very risk averse and we don't want to borrow to fund operations, so we don't want the obligation to pay out our partners at a guaranteed level until the end of the year." It doesn't matter what the specific objection or comment is, because our response is the same. Don't confuse BEP with cash flow. And don't confuse guaranteed pay with guaranteed monthly draw. What we agree to pay a partner by the end of the year, versus how we manage our cash flow, is rarely the same. We see a wide range of payout percentages. For example, one of our firms pays out at a rate of 100 percent (spread out monthly) of expected BEP during the year and on the other extreme, we have a firm that pays out expected BEP at a rate of 35 percent (spread out monthly). Managing your cash and managing overall partner pay expectations are two different issues and should be dealt with independently.

Now, back to the numbers above. Once you've established what a reasonable BEP is per partner (usually based on past earnings, average earnings, earnings expected based on the partner compensation model or whatever makes sense at that firm) and once you have established the compensation framework variables as to the base and incentive portions, the rest is simple math. In the case above, if you look at the pay for the partner with the name of Alpha, he/she has a BEP of $175,000. Incidentally, it is often common for a new partner to make somewhere between $175,000-$200,000 annually. In that sense, it might represent the floor for partner pay at the firm. (Obviously, this varies between firm size and the economy of the area where the firm practices.) Eighty percent of $175,000 is $140,000 for the guaranteed pay, with 20 percent ($35,000) expected as incentive pay. As we have covered in our previous articles on this topic, the incentive pay we are introducing here (the $35,000 in this example) represents 100 percent of expectation, with 100 percent being what every partner should achieve, with a range of actual achievement pertaining to incentive pay typically being from 50 percent at a low (technically, it could be zero, but we have never seen that level of poor performance) to 200 percent (and we have seen goals achievement in excess of 200 percent, but 200 percent normally is at the high end of the range).

Next, we'd like to recommend that you consider reviewing, if necessary, the previous installments in this series that cover how we set up partner goals. Once those partner goals are established, and they are monitored with clear communications from the managing partner to the partner throughout the year, at year-end a final determination is made. For simplicity of our

case study, let's assume that Alpha had four goals that made up his/her at-risk or incentive pay. See the table below.

Alpha's Goals:	%	Calculation	Achievement	Performance Pay
• Goal 1:	20%	$ 7,000	125%	$ 8,750
• Goal 2:	30%	10,500	90%	9,450
• Goal 3:	15%	5,250	150%	7,875
• Goal 4:	35%	12,250	100%	12,250
Total:	**100%**	**$35,000**		**$ 38,325**

As you can see, it was determined that Alpha overachieved Goal 1 by 25 percent, underachieved Goal 2 by 10 percent, overachieved Goal 3 by 50 percent and hit Goal 4. This kind of pattern is common as some goals are easier for different partners to overachieve and vice-versa. The key here is to understand that normal performance, not excellent performance, should meet the 100 percent mark, so paying the 20 percent at risk portion of a partner's pay is expected to occur if he/she just has an average performance year. If partners underperform, they don't earn their expected pay. Similarly, they can earn more than expected when they have a better than average performance year. It is also common for your top partners to overperform in every category.

Now, let's take a summary view of all of the partners, assuming each had a number of goals, and their incentive pay was finalized according to the table below.

Partner	BEP (Total)	Base Pay or Guaranteed Pay	Incentive Pay or At Risk Pay	MP Goals or Performance Pay
Alpha	175,000	140,000	35,000	38,325
Bravo	350,000	280,000	70,000	85,000
Charlie	200,000	160,000	40,000	35,750
Delta	425,000	340,000	85,000	101,500
Echo	275,000	220,000	55,000	75,000
Totals	**1,425,000**	**1,140,000**	**285,000**	**335,575**

In the scenario above, the partners earned, according to their at-risk performance, $50,575 more than expected ($335,575 less $285,000 = $50,575). So, let's consider several scenarios on how we move forward from here.

Be Smart about How You View Overall Variances in BEP and Actual

The first mistake typically made when assessing goal performance, especially when actual profits are in line with budget or a little less than budget, is that no incentives will be earned by any partner. In other words, given the lack of excess funds, it is assumed that everyone will just earn their BEP. This is a terrible conclusion because, when actual profits are hovering in this less-than-stellar range, the assumption that everyone equally pulled their weight is rarely true. So, the conclusion that since there is no extra money, no one should earn incentive pay, is not only demotivating, but actually unfair. In this situation, the odds are that a partner or two performed well, maybe even exceptionally so, and just because that performance was not enough to make up for the other partners' shortfall in expectations doesn't mean that it is OK to

simply write-off the efforts of the performing partners. Therefore, we recommend that you always assess goal accomplishment and incentive pay as if there are ample resources and then adjust accordingly as a subsequent step.

Now that we know to evaluate individual performance first regardless of the firm's budget-to-actual performance, next we have to adjust the calculated performance pay to actual available profits. This adjustment is almost always up or down as rarely does the performance evaluation independently line up exactly with profits on their own.

Actual Profits in Excess of BEP

Let's first take a look at a positive variance on profits – where profits are in excess of BEP. There are many common approaches to this adjustment. The first, with which we disagree, is to adjust pay proportionally upward based on total pay. We also don't think firms should simply allocate the remaining profits based on ownership either. Typically, ownership is reflected in pay in the first place as we tend to find the owners with the largest equity stakes earning the highest salaries anyway, so allocating excess profits based on total pay often isn't much different than allocating the excess profits on ownership. Additionally, ownership often has an impact on retirement pay, so when this is the case, owners get the benefit of running a profitable firm there too. What we recommend is that additional profits be allocated based on the incentive pay earned. This naturally favors the higher-paid owners (because in raw dollars, their earnings at risk are greater and therefore still have a significant weight when it comes to the denominator for total earned incentive pay), but it also recognizes that any partner at any pay level may have contributed exceptionally and should be rewarded appropriately in that year for their accomplishments.

Let's take a look at the table below to see these methods at work. Assume actual profits were $125,000 more than BEP, totaling $1,550,000 instead of the budgeted number of $1,425,000. The first step is to reduce the assessed extra incentive pay of $50,575 from extra profits of $125,000, since the incentive pay calculation already has accounted for this part of those excess earnings. This leaves a difference that is not already reflected in the numbers below of $74,425 ($1,550,000 - $1,425,000 - $50,575 = $74,425). That amount is then typically handled one of two different ways. The second column to the right distributes the excess of $74,425 by total pay and the last column to the right distributes the excess based on incentive pay.

Partner	BEP (A)	Earned MP Goals Or Performance Pay (B)	Total First Round Earned Pay (C)	$74,425 Profits In Excess of BEP Allocated by Total Pay (D)	$74,425 Profits In Excess of BEP Allocated by Incentive Pay (E)
Alpha	175,000	(B1) 38,325	(C1) 178,325	187,320	186,825
Bravo	350,000	(B2) 85,000	(C2) 365,000	383,410	383,851
Charlie	200,000	(B3) 35,750	(C3) 195,750	205,623	203,679
Delta	425,000	(B4) 101,500	(C4) 441,500	463,768	464,011
Echo	275,000	(B5) 75,000	(C5) 295,000	309,879	311,634
Totals	**1,425,000**	**(F) 335,575**	**(G) 1,475,575**	**1,550,000**	**1,550,000**

As you can see, the numbers are not significantly different. However, allocating the excess profits based on the incentive pay is, in our opinion, a fairer way to reward those partners who had the greatest impact on this year's total profitability when incentive pay is intended to recognize efforts and accomplishments of the current year. To help with the math, here are the formulas for the last two columns (see the letters assigned to each column):

- Allocating Excess Profits based on Total Pay: $74,425 * (C1-5/G) + C1-5
- Allocating Excess Profits based on Incentive Pay: $74,425 * (B1-5/F) + C1-5

BEP in Excess of Actual Profits

Now for the more difficult question: what happens when there are less profits than budgeted? The reason why this discussion is difficult is because when there are excess profits, everyone gets more than expected, so while they might have wanted even more than allocated, they are still happy given that they got more. However, when a firm makes less than expected, most people will be taking home less than they expected, which creates much more frustration, hostility and a desire to micromanage the process to attempt to influence the final outcome.

When profits are less than BEP, we recommend that you still start by evaluating everyone's performance as if there are ample resources. Then, with those numbers, allocate downward to the available profits. We recommend just the opposite approach for the allocation downward than we did for the upward allocation. We believe that firms should allocate downward based on total pay (base plus evaluated incentive) rather than just evaluated incentive pay. The reason is that since base pay reflects 80 percent of the BEP, allocating on incentive pay alone could be overly punitive in isolated cases when the firm is allocating a shortfall.

Review the table below assuming a shortfall from BEP of $150,000 from the budgeted $1,425,000 to $1,275,000. The numbers we are using would rarely ever occur, because we are showing an evaluated additional incentive of $50,575 at the same time when the firm fell far short of its budgeted profits. (So in real life, while there would likely be partners who earned excess incentive pay, most would earn normal pay or less.) Because this is a case study, we are continuing with the same numbers for base and earned incentive for consistency to more clearly show how the process works with adjustments either up or down.

In this case, not only do we need to adjust downward overall for the $150,000 shortfall, but we also need to adjust downward the excess $50,575 incentive pay, for a total adjustment of $200,575.

Partner	BEP (A)	Earned MP Goals Or Performance Pay (B)	Total First Round Earned Pay (C)	$150,000 shortfall Plus $50,575 Incentive Pay Allocated by Total Pay (D)	$150,000 shortfall Plus $50,575 Incentive Pay Allocated by Incentive Pay (E)
Alpha	175,000	(B1) 38,325	(C1) 178,325	154,085	155,418
Bravo	350,000	(B2) 85,000	(C2) 365,000	315,385	314,195
Charlie	200,000	(B3) 35,750	(C3) 195,750	169,142	174,382
Delta	425,000	(B4) 101,500	(C4) 441,500	381,487	380,833
Echo	275,000	(B5) 75,000	(C5) 295,000	254,901	250,172

Totals	1,425,000	(F) 335,575	(G) 1,475,575	(H) 1,275,000	1,275,000

Once again, the numbers are not a lot different, but allocating down by total (guaranteed pay plus evaluated incentive pay) makes more sense when you look at who performed and how the numbers above came out. To help with the math, here are the formulas for the last two columns (see the letters assigned to each column):

- Allocating Shortfalls from BEP: $150,000 shortfall, plus $50,575 excess evaluated incentive proportionally down based on total pay: (H/G) * (C1-5)
- Allocating Shortfalls from BEP: $150,000 shortfall, plus $50,575 excess evaluated incentive proportionally down based on incentive pay: (($200.575 * (B1-5/F)) - C1-5)*-1

I mentioned earlier that we would discuss two common variations of incentive pay. Guaranteed pay plus incentive pay based on goals is the most common. But some firms create two types of incentive pay. One part or type is based on a very objective group of expectations, and the other group is more related to strategy and goal accomplishment tailored to the specific responsibilities of the individual partners. We have been discussing the latter. Some firms create objective metrics assigned equally to all partners to make sure partners meet some basic minimum partner roles and responsibilities. Those metrics might be a minimum and maximum number of charge hours, maintaining a minimum leverage ratio, managing a minimum size of book, turning in timesheets timely, billing timely, collections levels, etc.

As we discussed in the last article on this topic, these incentives are usually all objective and commonly “check-the-box” types of metrics (did he/she do it or not). They are also often meant to provide the compensation committee with an additional tool to utilize when assessing next year’s raises. So, if we go back to our 80/20 (base/incentive) example above, utilizing this additional incentive option, the compensation framework might shift to 70/10/20 (base/objective minimums/incentive). The compensation committee would be involved in assessing the base each year and the earned 10 percent incentive, because it would be determined based on easily reportable and trackable performance. The 20 percent incentive grounded in the firm’s strategic plan would still fall to the managing partner to oversee, with goals identified in advance, and performance monitored and evaluated throughout the year.

In the end, one approach or another will seem the most fair to the partners in your firm and that is the approach you should choose. As we have said above, with a one-part incentive system the key to the incentive process is for the managing partner to evaluate the goal accomplishments of each partner, assess a percentage earned for each goal and let the chips fall where they may as to the first calculation. The same is true for the two-part incentive system, except that the compensation committee, if there is one, needs to get involved, add the managing partner’s assessment to the mix and then let the chips fall where they may. Whether the firm earned more or less than BEP, it is time to then do the appropriate calculations to adjust upward or downward. And just because actual profits come in at or below BEP, that doesn’t mean you do away with the goal evaluation process, but rather, you need to complete it normally and make the appropriate adjustments afterward.

We hope this case study review over the past four articles on partner compensation “common points of confusion” has helped you clear up the roles and responsibilities of those who should be involved in your process, and provided you with some insight as to how to approach the final assessment and calculations to create a transparent and fair process for all of the partners.

From all of us at Succession Institute, LLC, we wish you a happy, healthy, prosperous holiday season and new year!

It's a Great Time to Own a CPA Firm

CPA firm revenues are surging. And average partner incomes are topping $400,000 per year.

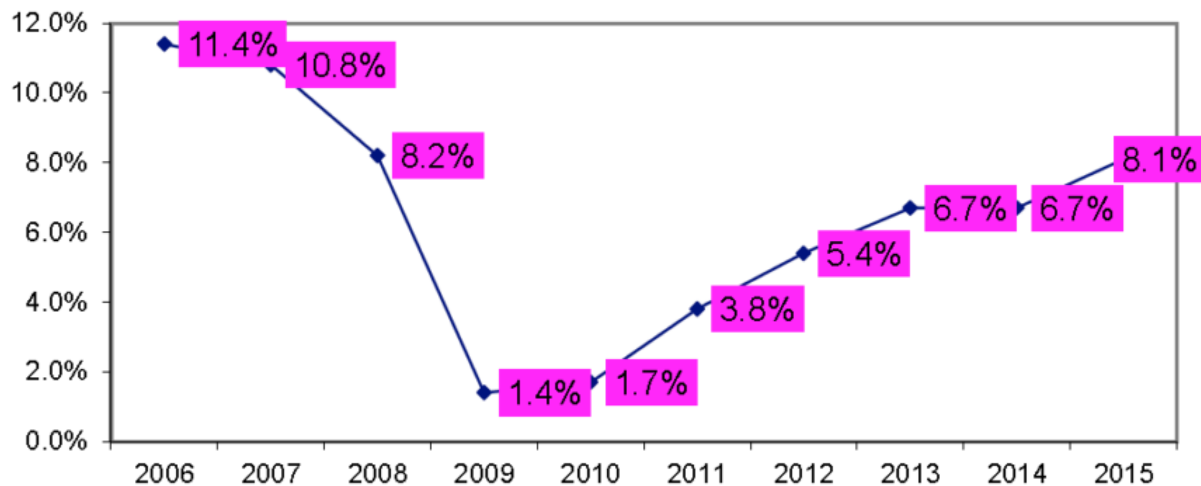
By Rick Telberg
CPA Trendlines Research

CPA firm revenues surged more than 8 percent in the just-released 18th annual Rosenberg MAP Survey, the strongest expansion in almost a decade. The advances are being fueled mostly by organic growth, with the merger frenzy showing no signs of slowing down and mergers accounting for about 28 percent of the new revenue, according to the survey.

However, the profession could be holding itself back, according to the authors, led by Charles Hylan of The Growth Partnership. The report cites four problematic issues:

1. Baby boomer clients are aging out of the market as they sell off their businesses.
2. Merger mania is distracting firm leaders from generating organic growth.
3. The "seemingly permanent" staffing shortage is curtailing practice development.
4. Partners are admitting they're just "not hustling as much for new business."

"Think what the potential for even higher revenues might be if not for the factors above which hold back growth," says the report.



Caption: Annual growth rates for firms grossing over $2 million per year.

Source: Rosenberg MAP Survey via *CPA Trendlines*

The largest of firms, those with $20 million or more in annual revenues, are posting a huge jump in growth from mergers: 31 percent of their growth comes from mergers, up sharply from 16 percent the year before.

CPA firm profitability, as measured by income per partner, is running at about $406,000, up almost 4 percent from the year-ago period – the highest annual increase since 2007. The reasons:

1. Dramatically higher leverage, measured primarily by professional staff-to-partner ratios and evidenced by lower partner income percentages than the prior year,
2. Fewer equity partners carried by firms and
3. A small increase in billing rates.

"We're calling it the year of dramatically higher leverage," the authors say, calculating the ratio of professional staff to partner.

"The large increases in staff-to-partner ratios – in all size categories – are unprecedented in any of our 17 previous annual surveys," they say. Noting that despite the revenue increase, firms are not adding much to their payrolls, while actually reducing the number of partners.

Meanwhile, the data suggest that firms are making huge leaps in productivity. The Rosenberg MAP Survey lays claim to linking 10 key metrics to profitability. And it notes: The four metrics correlating the strongest, by far, to income per partner have been revenue per partner, revenue per person, billing rates and staff-partner ratio. The conclusion has always been that leverage and rates are the most important keys to profitability. The metric correlating the highest has always been revenue per partner. The metric correlating the second highest has always been revenue per person.

This year, something changed. For the first time, revenue per person shows a higher correlation to income per partner – albeit slightly – than revenue per partner. Since revenue per person is a measure of efficiency – it measures how many people, whether professional or administrative, it takes to get the work out – this change corroborates the conclusion that firms are making great strides in operating more efficiently.

At the same time, the authors say, "The most overrated CPA firm metric in the business is total partner income as a percentage of revenues. The myth is that the higher this metric, the higher is profitability. Generally, profitability of around 33 percent has been average, and 40 percent to 50 percent considered very profitable. The problem with this metric as an indicator of profitability is that it is greatly impacted by the staff-to-partner ratio.

There is a very strong correlation of staff-to-partner ratios with incomes per partner – the higher the ratio, the higher income per partner will be. But high staff-to-partner ratios have the reverse impact on partner profits as a percentage of revenues; firms with lower partner income percentages outperform those with higher percentages. To many, this may seem

counterintuitive. But the facts show it. Consistent with the dramatic increases in staff-to-partner ratios this year is a decline in partner income percentages. This doesn't mean that firms were less profitable. Instead, it simply means that firms are more leveraged."

"We've been talking about the firm of the future for long enough and now it's upon us," adds consultant Chris Fredriksen, one of the report's 17 analysts. "Firms don't want to wait any longer, because the requisite technology is already available and they are seeing the gains being made by full-service, low-price competitors. Firms are acknowledging the disruption that is hitting the industry – clients are demanding real-time, up-to-date, in-the-moment information 24/7 at a reasonable price. The challenge for firms is getting clients to move away from desktop to online SAAS technology, which is inevitable but painful. This year is the tipping point – it's not just the early adopters who are on board, but the regular adopters are getting there too."

At the same time, the number of partner retirements is hitting historic highs. For the first time in memory, the number of partners over age 50 is declining, standing today at about 66 percent of all partners, down from 70 percent the year before.

Other highlights include:

- Revenue growth of 8.1 percent per firm, the strongest revenue showing since 2008.
- Thirty percent of firms are growing by more than 10 percent and 60 percent by more than 5 percent.
- Mergers continue to have a huge impact on revenue growth, with 28 percent of firms' revenue increases from mergers.
- Income per partner stands at $406,000, 3.6 percent higher than the prior year, and the fastest increase in profitability since 2007.
- Researchers were shocked by the reduction in the number of partners. Despite the robust revenue growth in the industry, firms in all size classes experienced a decrease in their partner ranks that ranged from 2 percent to 9 percent. This played a huge role in the dramatic increase in partner-to-staff leverage.
- Consulting revenues increased, particularly among firms over $10 million.
- CPA firms are steadily transitioning their partner compensation systems to committee structures, away from formulas.
- New partner buy-ins increased this year to $163,000 from $144,000 last year, an increase of 13 percent.

About the Author: *Rick Telberg is founder and CEO of CPA Trendlines Research, which provides actionable business intelligence services to tax, accounting and financial firms at cpatrendlines.com. The complete report is available at cpaclick.com/map_report.*