December 2013

This electronic newsletter is prepared especially for public practitioners and is sent bimonthly to members of the Puerto Rico Society of CPAs. This e-newsletter features regular commentary from Bill Reeb, a CPA firm consultant based in Austin, Texas.

From the BILLiverse
Continuing the discussion on succession planning, Bill Reeb, CPA, details what a successful succession plan should include in his final column. According to Reeb, if you take time to think through and address each of the topics included in this column, you will be more than ready for succession.
Take a look.
Read Reeb's Commentary

Marketing Tip: Take Advantage of Planning Season – Connect with Clients
With busy season in plain sight, Krista Remer and Tamera Loerzel from *ConvergenceCoaching LLC* offer client retention tips to implement now in the following article. By taking time to check in with your clients, you'll keep your firm top-of-mind with your clients when your competitors proactively reach out to them. You might find new service opportunities as well!
Learn More

Busy Season Outlook: Tough, Competitive and Uncertain
Key findings so far in the *CPA Trendlines* Busy Season Survey suggest practitioners have learned many of the same lessons from last year and will be applying them aggressively this year, setting up the possibility of a particularly competitive marketplace amid an uncertain political and regulatory environment. In the following article, Rick Telberg, CPA, discusses the survey's findings and shares how CPAs are applying lessons learned from last year.
Learn More

Five Things CPAs Should Consider before Year's End
CPA firms traditionally have very hectic December schedules due to the culmination of interim audit work along with year-end tax planning for clients and the firm. Still, this is the optimal period to position the firm for a prosperous 2014. Blake Christian, CPA, shares five suggested areas of focus for CPAs through the end of the year.
Read the Article
http://www.cpa2biz.com/Content/media/PRODUCER_CONTENT/Newsletters/Articles_2013/CPA/Dec/CPAsYearEnd.jsp

Six Trends that are Reshaping Business
While speaking at AICPA's Governing Council meeting in October, University of North Carolina Chapel Hill professor James Johnson, Ph.D., said the numbers describing the demographics of the United States leave accountants little choice today but to embrace diversity and new business practices. In this *Journal of Accountancy* article, he shares his top six demographic trends that will require change, along with six tips the accounting profession should consider as we embrace these changes.
Read the article
http://www.journalofaccountancy.com/News/20138920

Honing Your Hiring
It takes some detective work to hire the right new employee. Management needs to piece together clues about the applicant's personality and work history. It takes time to determine

whether a candidate has the character and credentials to fit the firm's needs. This *Journal of Accountancy* article offers a few steps to help you land the right candidates.
Read the Article
http://journalofaccountancy.com/Issues/2013/Dec/20138797

Survey: Data Security Concerns Soar as more CPA Firms Access Cloud
Concerns about data security are surging as the percentage of CPA firms tapping cloud computing continues to increase, according to a survey from CPA2Biz. Almost 43 percent of the firms polled said that they are "somewhat confident" or "not confident at all" — the two lowest categories — in cloud vendors' ability to manage data breaches and maintain effective internal controls. That's up from 15 percent last year.
Read the Journal of Accountancy article
http://journalofaccountancy.com/News/20139126

How to Value a CPA Firm for Sale
One of the key components of a CPA succession plan is the sale or transfer of the retiring CPA's ownership interest. How is the value of that interest determined? In most circumstances, the value of an owner's interest is different when selling to an external buyer than it is in an internal transaction.
Read the Journal of Accountancy article
http://www.journalofaccountancy.com/Issues/2013/Nov/20138232.htm

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SUCCESSION FUNDAMENTALS – PART 7

BY BILL REEB, CPA, CITP, CGMA

Now, for the final column on Succession Fundamentals. In our last column, after discussing issues to consider regarding retiring partners, we started down the road of identifying the various sections that should be included in any succession plan. The point of this last section is not to present you with a sample succession plan, but even better, to describe topic areas you should address in your plan.

Throughout this succession series, we have been covering various best practices to consider as you put your plan together. For any succession plan to work, you have to start with consideration of the business model you use:

Section 1: Identify and Describe Your Business Model

Your choice of business model, with the two most common being Eat What You Kill (EWYK) and the One-Firm (or Building a Village – BAV - concept), will drive many of the choices you will have make to create and effectively implement your succession plan. For example, if you are an EWYK firm, then when it comes time to sell, you see if anyone wants to buy your clients, with the partners of the firm having a first right of refusal, based on client retention paid out over four to five years without interest. Under an EWYK model, you get to enjoy the spoils of your success while working. When it is time to leave, you sell your relationships for what you can get and hope whoever buys your book of business will keep most of your clients. Our experience is that if you sell your practice for a $1 for a $1 in client book, if the departing partner makes an effort to motivate the clients to stay with the new firm or transitioned partner, the retiring partner will likely receive about 65 to 70 cents on the dollar. If the retiring partner does not make an effort in transition, or the buying partner or firm doesn't work hard to keep them, then this number will go down fast. Since the purchase is based on retention, the buyer's motivation and integrity is critical to getting paid as the buyer could just cherry-pick a few clients, pay a $1 or even $1.5 for each dollar of revenue and still leave the retiring partner with little to show for their hard work over the years. Under this model, everything is a negotiation, from what clients are sold, to what the retiring owner might be allowed to do work-wise going forward, to any other term that either side is interested in discussing. This is because under the EWYK model, the succession plan is simply to sell your book of business and hope you have someone willing to buy it at a reasonable price and work hard to maintain those client relationships.

Succession planning under the BAV (One-Firm) model is quite different from that under the EWYK model. As discussed earlier in this series, there are a number of ways to value the firm and a big advantage of this model over the EWYK model is that the partner can expect to be bought out at the time of retirement with some specificity as to the terms of the buyout. Because the remaining partners are obligated to buy the retiring owner out (based on whatever valuation method they choose – we discussed several common ones in part two of this series), that obligation comes with a number of expectations or conditions. They are that the firm will be ready:

- With someone who can build and cement relationships with the retiring partner's clients in order to retain them
- To replace the retiring partner with sufficient physical capacity to get the work done
- To replace the retiring partner's technical skills so that someone can actually do the work that the retiring partner was doing.

Once you consider the business model, it then makes sense why the second point of consideration is the retirement benefit:

Section 2: Outline the Retirement Benefit

The Vesting requirements need to be outlined in order for the retirement benefit to be fully determinable. So, sections addressing the following points need to be laid out in detail to close the loop on the retirement issue:

- Vesting,
- Penalties for leaving with adequate notice
- Penalties for early retirement with notice and
- Mandatory sale of ownership (MSO)

Take a look at part two of this series for coverage of MSO and part six of this series for some vesting ideas.

The next section to write up in your succession plan is that of governance and all that it entails:

Section 3: Describe Governance, Roles and Responsibilities

Take a look at part six of this series for some of the standard positions in governance for which you should consider developing powers, limitations, roles and responsibilities. As well, take a look at part four of this series which introduces two common partner roles you might consider formalizing. Finally, take a look at the four-part series of columns called "Partner Roles and Responsibilities" for more ideas to help you.

In addition, it is critical to manage the voting and ownership processes. This means that the firm needs to outline how it will deal with equity distribution and voting rights and processes. This is one area that can't be over-emphasized as to its importance. How you determine who gets what say and how that say plays into decisions can make the difference between long-term success and failure.

Section 4: Explain Voting Rights, Decision Making and Equity Distribution or Redistribution

In part six of this series we provided more insight into these topics. As well, refer back to the three-part "Equity Allocation and Reallocation" series of columns to see how we suggest you address ownership.

As part of this same definitional section of the document, you also need to identify a Golden Parachute for the managing partner:

Section 5: Draft Your Managing Partner Considerations

The purpose of this provision is to make sure that the person filling the managing partner position is protected if he or she is removed from that role. In order to do the job properly under the BAV model, the managing partner needs to be in a position to consider the firm as his/her largest and most important client. This usually requires a reduction in managed book size so that the firm can become the managing partner's key priority, together with an expected compensation package for filling that role. Therefore, when a partner is removed from the role of managing partner, they need to be assured that the firm is committed to putting them back into a line-partner position that is consistent with where they would have been had they not taken the managing partner position.

Next, the firm should outline the strategy as to how it will continually build the necessary capacity to replace the retiring partners and create more leverage for the remaining partners to make the financial aspects of the BAV model work. This area of the succession plan has multiple components:

Section 6: Sharing Your Strategy for Building Capacity for Long-Term Sustainability:

- Developing Real "People-Management" Skills
- Learning How to Develop People More Quickly
- Closing Competency Gaps

Review part four of this series for some ideas on these topics. As well, consider looking at the six part series of columns called "Management and Leadership in a CPA Firm."

Now that we know what model we are going to use to operate our firm; when people will retire and under what terms and conditions; the governance that will hold the partners and firm personal accountable; and the strategy for creating capacity and closing competency gaps through the efficient and effective development of people, it is time to move onto the next section, which is defining transition:

Section 7: Define the Process for Transitioning Client and Referral Relationships; Penalties for Improper Transitioning and the Fact that When a Partner Enters the Transition Phase, he/she will be Under a Special Compensation Framework

This section review how the firm is going to hold partners accountable for transitioning their clients and how they will be paid during that slow-down period. This process actually has quite a bit of trickle down effect to it because typically once a transition plan is created for a retiring partner, a similar plan has to be generated for multiple positions below the departing partner in order for each level to free up capacity to take on the work being handed down. Part three of this series provides some good insight into this area as well as the two part "Client Transition" columns.

Next, we need to talk about how to bring in a partner. So we need a section on admission to ownership:

Section 8: Describe the Admission to Ownership Process

We are big fans of bringing in partners at accrual basis book value buy-in, and then buying them out when their sweat equity has earned them retirement benefits. This in turn requires vesting, which usually doesn't even result in partial vesting until around age 60. Way too many firms have partners buy in at market. The problem with that model is that if someone buys in at market, you don't have a good argument as to why someone can't leave at any time they wish and be bought out at market (i.e., why would I pay market and get anything less than market when I decide to leave?).

A major reason organizations bring in younger partners is to create a succession strategy. They need people who will be ready to take over and run the firm when it is time for the senior partners to go. Therefore, we don't want partners leaving anytime they want to go, but in an orderly fashion once they have worked for us long enough as a partner and reached a retirement age. We can tell you from experience that, if the younger partners can sell out at any time at full value, many of them will decide to cash out right before the senior partners retire. When this occurs, the question so often asked at that point is, "What happened. Didn't we make it clear that our younger partners are supposed to buy us out, not the other way around?" And if this isn't enough, here is another important reason not to require the buy-in to be at full market value – you are going to give them the money to buy you out in the first place. Regardless of the price charged to buy in, the firm ends up adjusting the new partner's income so that he/she can effectively buy-in without a reduction of income—so the more he or she is paying to buy in, the greater the upwards adjustment in pay required. Anyway, regardless of your choices in this matter, you need to include a section identifying the buy-in process and pricing model for admission.

Logically, if we are going to talk about people buying-in, we also need to talk about people leaving. Since we discussed departure for retirement earlier, we now need to address the other departures, including voluntary or involuntary withdrawal from the firm. When you outline this section in your agreements, you need to address a number of areas associated with people leaving and competing with your firm:

Section 9: Address People Leaving and Competing

- Benefits Available when Leaving and Competing or Not Competing with the Firm
- Penalties for Leaving and Taking Staff and/or Clients
- Vote Required to Terminate a Partner

As we've discussed in previous parts of this series, your firm should not be in the business of creating spin-off competitors, so you need to think through how you will address partners who leave and take clients and/or staff to compete with your firm. This usually involves a reduction in what they receive in retirement benefits and liquidated damages owed to your firm for clients and staff taken—and the damages need to be high in our opinion, in the range of 200% of client fees and staff salaries.

The voting percentage required to terminate a partner is critical to succession management. If you are going to operate under the BAV business model, you have to be able to hold partners accountable to following systems, processes and procedures. When a partner will not comply, you need to first be able to motivate them to comply by penalizing them financially. If that doesn't work, you need to be able to penalize them even more financially. And if that doesn't motivate them to change, then you need to be able to let them go. One of the biggest weaknesses we see is firms adopting such a high voting threshold to fire someone that it is almost impossible to let someone go. If this is the case, then your odds of being able to effectively run your firm under the BAV model are minimal since you don't have a way to cut partners from the herd who have made it clear that they will not comply with operational policy.

Next, you need to establish the rules of conduct and operational processes for those ex-partners who retire and still want to continue working in some capacity for the firm. Obviously, this means they will be working differently than they did before. And even more important, they won't be working for the firm at all if the firm doesn't specifically invite them to continue working (and we believe the maximum length of that invitation should be one year at a time). Therefore, you need to define how you will deal with this prospect:

Section 10: Outline the Processes and Procedures for Retired Partners Still Working for the Firm

We spend time in both parts five and six of this series outlining the "do's and don'ts" of this issue.

To ensure that the firm can pay those who have retired or left without putting the firm's sustainability in jeopardy, a policy has to be developed to puts a cap on the maximum amount of money that can be paid out to departed partners. So you need a section addressing the maximum amount of payout in any year:

Section 11: Describe the Maximum Payout Process

In order to protect the firm in the event that it has a poor year, usually a cap is set on how much of the firm's net profits before partner compensation will be paid out to retired partners. If the amount due to the retired partners exceeds the amount under the cap, the excess owed to them gets tacked on to the payouts and paid out over a longer time period, usually with any deferred amounts carrying interest until caught up.

At this point, it is time to layout the compensation framework:

Section 12: Discuss the Partner Compensation Framework

The framework needs to be flexible enough to dramatically change every time the firm's strategies or priorities change. The job of the partner compensation system is to motivate partners to achieve their part of the firm's strategic plan. Compensation is the incredibly effective tool an organization can use to reward those people who are contributing to the firm's success and make it clear to those who are not that they need to change their behaviors. The partner compensation framework needs to be supported by firm policy in such a way that it enables the managing partner to hold the partners accountable to achieving whatever goals are assigned to them. But at the same time, it has to be set up with enough balance that the managing partner doesn't gain so much control through the compensation process that he or she is in a position to usurp powers that are reserved for the board. For an in-depth discussion on this topic, refer back to the "Accountability for Performance Management" series of columns.

Finally, your succession plan has to address how death, partial or full disability are handled when they occur. Therefore you need a section that addresses death and disability:

Section 13: Review How Death and Disability will be Managed and Compensated

We suggest that provisions addressing buyouts for death and disability take into account the fact that someone's departure under these conditions can place the firm in some serious financial risk, if only due to the inability to properly transition client and referral relationships and develop the capacity for someone to take over for the departed partner. As well, special attention needs to be paid to situations where a partner comes and goes—in and out of disability—over time and how that will be addressed by the firm. These critical areas need to be addressed in a way that is fair and equitable to both the departing partner and to the firm and they normally are covered separately under death, partial disability and total disability provisions.

In Conclusion

Our stance, in everything we do working with firms, in what we write in our books and what we talk about when we speak, is that succession is the natural and seamless evolution of managing a well-run firm. But if your firm is not following best practices, then succession will turn a spotlight on every weakness the firm has. We believe that if you take the time to think through and address each of the topics above, you will be more than ready for succession. As well, you will be one of the few firms on the planet with a truly robust succession plan to form, guide and direct your upcoming change in leadership.

Good succession management is about ensuring that when key people leave, the firm doesn't redefine everything it is doing, but continues to operate on sound foundational principles with the only real difference being a change in "who" is filling key leadership roles and responsibilities.

We wish you the best of luck drafting your succession management plan. And hope you have a happy, healthy, prosperous holiday season and New Year!!!

Take Advantage of Planning Season – Connect with Your Clients

If you're committed to deepening client relationships and delivering exceptional client service, it is critical to proactively meet with clients outside of your regular engagement periods to further your relationships, identify any potential service issues, and uncover new opportunities to add value. You may be nodding your head in agreement as you read this. However, when client surveys are conducted, clients repeatedly indicate that they wish their CPA would contact them "out of cycle" and "for no reason." This means that you can likely do more than you are today.

Client retention is a top concern raised by practitioners in a recent AICPA PCPS CPA Firm Top Issues survey, and it's something each of us aspires to ensure. Yet few of us are disciplined enough to proactively outreach to our clients because this type of behavior falls in what Stephen R. Covey defined in his book, The Seven Habits of Highly Effective People, as Quadrant II tasks – those that are important but not urgent. Unless we owe our clients something immediately or they have a problem or complaint, our tendency is to put off any outreach and let it fall to the bottom of our list week after week. **We also may make up that "no news is good news." If we don't hear from our clients, then everything must be okay.** The opposite may very well be the case, though, as Ken Blanchard points out in his book, Raving Fans, and the silence should be worrisome to us.

So, break the silence. Uncover ways you can increase your value to your clients and deepen your relationships with them. Simply commit to reach out to one client a week (or be bold by calling one and having lunch with a second!). **When our CPA firm clients have done this, they have been surprised by how thrilled – and surprised – their clients are to have their CPA calling them or asking them to have lunch just to check in!**

Fall and early winter are prime selling seasons, too, so while you're in the midst of the planning season, **consider asking each client owner in your firm to set a goal to meet with a certain number of clients each week to find new opportunities to help them.**

When you meet with your clients, ask questions that demonstrate your interest in them and build your relationships, including:

- How are things going in your business (or your life) these days?
- What changes are there in your team (or your life)?
- What concerns you most today?
- What critical decisions are you facing?
- What opportunities are you contemplating?
- What plans do you have to capitalize on them?
- How are we doing for you?
- What can we improve?
- How can we be of more help to you?
- Would you be willing to act as a reference for us?

Discuss the results of your client meetings during your regular sales pipeline meetings, being sure to add any new service opportunities you identify to your pipeline. Or, schedule time for all of your client service owners to share successes, troubleshoot any client service issues that may be raised, and plan for the follow up that you committed to your clients.

When you take the time to check in with your clients, you'll find new service opportunities to pursue and keep your firm top-of-mind with your clients when your competitors proactively reach out to them (which they will do!). Schedule your client check-in meetings starting today to deepen your relationships and uncover ways to increase your value to them.

Tamera Loerzel is a partner and Krista Remer is a consultant of ConvergenceCoaching, LLC, a leadership and marketing consulting and coaching firm that specializes in helping leaders achieve success. Learn more about the company and its services at www.convergencecoaching.com.

Busy Season Outlook: Tough, Competitive, and Uncertain

CPAs Apply Lessons Learned from Last Year

By Rick Telberg
CPA Trendlines
Most tax practitioners across the nation are preparing for the 2014 busy season with the confidence that it can't possibly be as bad as last year's "worst tax season ever," according to exclusive CPA Trendlines polling.

The CPA Trendlines Busy Season survey, now approaching its 11th year, canvasses the profession nationwide, providing a special preview of the topline results to those who participate in the three-minute questionnaire. Join the survey; get the results.

Key findings so far suggest many practitioners have learned many of the same lessons from last year and will be applying them aggressively this year, setting up the possibility of a particularly competitive marketplace amid an uncertain political and regulatory environment.

"We already know early that the season will be delayed," says the owner of a small firm in Gresham, Ore., who's looking forward to a better season this year. "We have the experiences learned from last season being delayed. And we are hiring another staff member. With the addition of a staff member we should see all figures increase positively and extension numbers decrease."

CPAs forecasting advances in revenues and profits seem to share some common strategies:

1. Raising rates
2. Cutting unprofitable, problematic clients
3. Stronger new client acquisition efforts
4. Add-on revenues from clients with increasingly complex situations.

George Prytula, III, CPA (also PFS, CGMA, CFP, LLM Tax) of Heathrow, Fla., figures more than 30 years of repeat customers and having worked out the bugs of a new tax prep application last year will give help buoy his revenues this year, plus he has two new support contracts with Intuit, and one with a Canadian firm.

In Westerville, Ohio, CPA Murray Mika figures, "Businesses as a whole are in a better financial position than last year. During the recession our clients cut back on using our services. Now that our clients' financial position has improved, they are using more of our services."

If there are themes among the new strategies from lessons learned last year, they fall into a few general categories:

1. Client management – Manage expectations. Get them in earlier. Foster use of portals and electronic communication.
2. Business development – More marketing, for less spend. Bigger reliance on the Internet and social media.
3. Technology – Leveraging the cloud, paperless and integrated systems to smooth workflows gain efficiencies and reduce turnaround times.
4. Staffing – Staff up early. Invest in training.

In the face of the uncertain economy, CPA Raymond G. Klinc in Solon, Ohio, has "cut some marginal clients and replaced them with higher quality clients." He's been working to make the firm more competitive for the last 12 months by "working harder, stressing productivity, and stressing service. If you are just starting to change now you are too late."

Others are rushing to embrace new technologies, adjust prices (either up or down, or both), onboard new staffers faster, and intensify new business development efforts.

In Lynnwood, Wash., a local CPA firm has "implemented new workflow and return-tracking processes that should make delegation easier so we can work more efficiently." At the same time, "We saw great results from our marketing strategy, which started to kick in at the end of the season last year. I expect greater growth, and I expect that we're better prepared to handle it." In addition, "I think the Affordable Care Act will impact many of our clients negatively, but it will increase our retention rate because taxes aren't getting any easier."

In Salem, Ohio, Roger Hack, name partner at the mid-sized Hack Steer & Co., is also hopeful for "no fiscal cliff disaster this year." In addition, "clients are in better financial shape, in general. However, many are still struggling." But since last year, the firm has achieved "more efficiencies in our office" and put "more staff in place."

The CEO at a relatively large CPA firm based in Modesto, Calif., is hopeful, as well, that there will be "no last-minute tax changes." Of course, he's still concerned by late or unprepared clients, intensifying competition, and yet-to-be-finished upgrades to the firm's operations.

And ObamaCare is proving to be a double-edged sword, with many accountants worrying that the sheer uncertainties will depress business activity, while reaping new fees from helping clients sort it all out.

> *Rick Telberg is president and CEO of CPA Trendlines Research, at cpatrendlines.com, delivering actionable business intelligence to tax, accounting and financial professionals to aid in their practices and careers. To join the three-minute survey mentioned in this article and get a special preview of the results, go to:* https://www.research.net/s/your-CPA-society