CPA Practice Advisor

Percentage

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Firms over-emphasize the importance of ownership percentage. We have repeatedly stated this opinion in our blogs and monographs.

Taken to extremes, ownership percentage can be used to drive all of the "big 4" partner issues: partner income allocation, partner buy-in, partner buyout and voting. At many firms, ownership percentage may not be the sole driver of these partner issues, but still plays an important role.

The reason for reducing the emphasis on ownership is simple: the array of partner ownership percentages are often totally unrepresentative of the value contributed by each partner.

Instead of the heavy reliance on ownership percentage, here is how many firms make their decisions on the "big 4" partner issues:

- Comp is based on performance, not ownership percentage.

A partner from a 5-partner firm in the Midwest writes:

I believe "Ownership Percentage" is important. Our firm requires new partners to buy at least an 8% position. We use your recommended formula of accrual capital plus goodwill. New partners use their annual bonus to purchase their interest in the company. Income is allocated–25% based on ownership and 75% based on performance. Voting is based on ownership. Before becoming a partner, you must first go through our one-year Partner-in-Training program. I'm sure there are a lot of ways to bring in a new partner, but this one has worked for us.

Our response:

Everyone is familiar with the old adage: "If it ain't broke, don't fix it." If all of your partners are truly happy with your system, and it doesn't alienate future partners, including those who join the firm via merger, then who cares what other firms do? By all means, keep using your system.

The operative words are "if your partners are truly happy…" I have found that partners frequently think they know how their partners feel, but the reality is, they don't. Partners don't voice their true feelings on sensitive matters, especially if there is a strong, dominating MP. My experience in working with firms is that when ownership percentage plays a strong factor in compensation and buyout, invariably, some partners are overpaid and some underpaid.

When firms have large buy-ins (the result of multiplying ownership percentage times the firm's capital + goodwill), the resulting buy-in requirement is often $400,000 or more. This steep figure discourages staff and prospective merger partners from wanting to buy in. If voting is based on ownership, then the newer partners will feel that their vote doesn't matter because it's so small.

I like your policy of having each partner serve a year in a partner-in-training

firm, The Rosenberg Associates, he is founder of the most authoritative annual survey of mid-sized CPA firm performance statistics in the country, The Rosenberg Survey. He has consulted with hundreds of firms throughout his 20+ year consulting career. He shares his expertise regularly on The Marc Rosenberg Blog.

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