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Practice Advisor

have competent replacement partners in place and a strong transition plan for ...

Terry Putney • Jan. 16, 2018

Surveys tell us a huge percent of accounting firms are facing the prospects of partners retiring in the near future. In most cases, this is going to lead to the need for the firm to buy the equity of the retiring partner, usually in the form of paying out capital and retirement or deferred compensation payments. We have found that many firms have partners that are either 1) nearing retirement or 2) that will be on the hook for the payments, and neither comfortable they have a good plan. A surprisingly large number of firms do not even have a formal owner agreement to manage this issue.

Consider the following as you evaluate your firm's situation.

transitioning client relationships and other duties, and ii) no incentive in their owner agreement to execute such a plan. No set of financial terms can compensate for a poorly executed transition.

How Can You Make Sure a Transition Plan is Executed?

Make sure your owner agreement requires enough notice of an intention to retire to allow enough time to execute the transition plan. We normally recommend at least two years. Even better are requirements in the agreement to actually execute a formal written plan. Failure to do either of these should result in a substantial discount in the buyout payments or in some cases making the payments contingent on post retirement client retention.

How Do You Know Your Terms Are Affordable?

Your buyout terms should be self-funding. If they are not, in order to make the payments the remaining owners will either have to i) borrow, ii) take a cut in compensation. Neither is likely to be satisfactory. The retiring partner's historical compensation is the capital available to make the payments. You use that to i) replace the partner's time, ii) make the payments, and iii) leave enough behind to motivate the remaining partners to take on the responsibility. In many cases we calculate the replacement cost as the retired partner's historical billable hours on their own production times 40% to 50%. A good target is to leave 50% of the retired partner's compensation behind as cushion. Normally you can modify buyout terms enough to meet this goal. This is really a matter of managing the cash flow so the payments don't create a problem.

What Are Typical and Realistic Terms for the Buyout?

Based on both what most firms in the profession are doing and what terms are often required to make the plan self-funding, the typical major terms for partner buyout/retirement payments are:

stretched to 15 years to match up with the amortization period.

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