Family Wealth Institute

Succession Planning for Accountants… Shoes for the Shoemaker

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Accountants are often considered the trusted advisor to business owners. Yet, when it comes to their own practices, we often find they have not paid enough attention to critical issues at the office.

Experienced business accountants are familiar with the popular statistics on the succession of family businesses. The data reveals that only 30% successfully transfer to the next generation and only one out of eight will survive the passage to the third generation of ownership. These statistics rarely apply to the professional businesses, including accounting firms.

Though the data is harder to find, we have found some important generalities

- Except in the large or more institutionalized firms, accountants rarely create written succession plans for themselves. The same can often be said of attorneys, physicians, and many other professionals.

- Most of the plans that are developed consist of buy-sell agreements which apply upon the death of a partner, and are most often partially funded with life insurance, but rarely priced on true economic values of the deceased partner's interest.

- Few of the succession plans anticipate or fund a buy-out based on the full or partial disability of the professional.

- Even fewer plans anticipate or pre-fund a buy-out upon the retirement of a partner.

- Clients of a deceased or incapacitated accountant will eventually move their matters to a replacement that they choose, and often pay only a fraction, if anything, of the outstanding bills owed to the former accountant. All the unbilled time related to work in progress is usually lost. Consequently, the value of the receivables and client work is considerably less than the accountant may have anticipated. In the meantime, there are continuing office expenses. This affects the cash flow to the family. Our experience suggests that the value of receivables and

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client relationships will deteriorate almost 50% in the first three months following the death of the accountant.

- Many clients may not realize their advisor has died, and assume that someone is handling their affairs. There is substantial risk of missed deadlines and timely follow-ups, so potential damages to clients become real and significant and the liability of the estate grows proportionately.

Here is what we know

- We are aware of no published guidelines regarding notification to clients, handling of timely compliance and reporting responsibilities regarding clients of the deceased accountant, preservation of client files, handling of work in process, or other fundamental duties routinely handled by the accountant.

- While planning for death is critical, the probability of disability is often two or three times greater. So disability planning is even more important.

May we suggest

- All sole practitioners should consider establishing a succession plan with colleagues whom they trust and to whom they would like to transfer their clients should they die or become permanently disabled. The nominated transferee agrees to accept the responsibility to gather the files, review them, and coordinate with the clients based on the various levels of action required. The price paid to the family of the deceased accountant and the terms and timing of the payment are the key challenges.

- Accountants who are in partnership with others may feel less compelled to create a succession plan, believing that their partners will handle the process, but this ignores many realities. In many professional corporations, partnerships and limited liability companies, the other partners come from different fields of practice and cannot service the clients of the deceased or disabled accountant. Audit partners do not want to or feel qualified to handle tax clients; forensic accountants do not like handling compliance matters. Even where there are accountants of similar discipline and experience, they often do not have the time or inclination to handle someone else's full book of business. The fall off in clients who remain with the firm is significant. Buy out agreements, where they exist, are rarely priced based on the real value of the practice, but rather on a financial statement book value or the amount of insurance the parties were willing to purchase. Few accounting firms purchase disability buy-out insurance, which functions like a death buy-out and cashes out the interest of the disabled partner. Consequently, thoughtful succession planning in these firms is equally important.

- Valuing an accounting practice is very difficult for all the above reasons. A successful strategy is based on an "earn-out" approach. Under this methodology, the Replacement Accountant agrees

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to pay the family of the deceased accountant based on a declining percentage of the actual fees paid to the Replacement Accountant. The percentage declines because, in the first year of the transfer, virtually all the economic benefit of the fees paid to the Replacement Accountant were generated because of the transfer but, as the years go on, these clients remain with the Replacement Accountant because of his or her skills and talents. We usually see a three to five-year payout period, and a percentage paid that typically begins around 40% of the revenue in year one to 10% of the revenue by year five. Thereafter, there is no further payment to the family. This arrangement is fair, because it is based on the real value of the book of business, rather than an estimated value which is rarely accurate, and is paid from the cash generated by the work.

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To contact the authors, please call the toll free number at 866-833-1112.

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