SO WHAT DOES BECOMING A PARTNER REALLY MEAN?!

By Allan Koltin

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This is the first of a bi-monthly series of columns by Allan D. Koltin, CPA, who is CEO of PDI Global, Inc. and a founding member of The Advisory Board. This is a very exciting time in the evolution of the accounting profession. Firms continue to expand and deepen the level of the services they provide; recruitment and retention are in the headlines, and the number of firms facing the transition of their leadership is unprecedented. These columns will cover these and other topics that are of interest to the accounting profession. We welcome your input and ideas, and we hope you will continue to look to CPA Practice Management Forum for guidance and best practices.

CPA PMF — What has been the historical definition of "partner"?

Koltin — Historically, making partner was somewhat equivalent to receiving tenure as a college professor. Simply stated, it meant that you had "arrived" and with it came a certain level of entitlement. One could argue that the parallel phrase "leave me alone" or "don't hold me accountable for anything" went with the territory.

CPA PMF — What is the present definition of "partner"?

Koltin — If you want to have some fun sometime, go to an Advisory Board or AICPA conference and ask this question of a bunch of managing partners during a networking break. My guess is that you will get as many definitions of "partner" as the number of people you ask the question of. It's hard to imagine that seven letters of the alphabet can cause so much confusion, conflict and controversy, but it's the world we live in.

CPA PMF — Why is there so much confusion around something that should appear to be rather straightforward?

Koltin — I think for a lot of firms there are two issues at hand. One is that, as firms have become run much more like a business, they have chosen to hold partners to a much higher degree of accountability. That being said, without a doubt, there are a healthy number of firms that wish they could hold their partners to a higher level of accountability, but unfortunately can't get some of the partners to move forward on this concept. With increased accountability has come an even broader range of partner performance levels over the past decade. There are some partners who are simply "off the chart" and other partners who are cruising and have basically "retired in place."

The second element of confusion has been the advent of the "lateral" partner. Over the past five years there have been more partners exiting national firms and joining local and regional firms than in the last three decades combined. This has forced many firms to also change the traditional one-tier partnership and develop two groups of partners (income and equity).

CPA PMF — Do most firms have a one-tier or two-tiered partnership structure today?

Koltin — The vast majority of Top 100 firms either have a two-tiered structure or are in the process of moving from a one-tier structure. This has given firms an easy way to bring lateral partners into the firm (as income partners) and provide a honeymoon period of six months to a year to find out if the lateral partner truly has the ability to become an equity partner. It also gives the lateral partner some "breathing room" to determine if this is the type of firm in which they want to invest their capital and with whom they want to spend the rest of their life. Probably what firms have struggled with the most is to provide an exact definition of what it takes to move from income to equity partner. Some firms have chosen to "grandfather" older partners and leave them in the equity ranks, although if you look strictly at their performance you could suggest that some of the income partners are actually outperforming them.

CPA PMF — Do income (non-equity) partners have any of the same rights as equity partners?

Koltin — This is a big discussion topic going on right now in a lot of firms. Some firms have said that income partners do not have to make a capital contribution, while other firms have said that they want a modest capital contribution from the income partners so that they have some "skin in the game." Some firms have said income partners should receive no retirement benefits (deferred compensation), whereas others have created a modest program of essentially up to 1 times the income partner's annual income. Lastly, some firms have said that income partners have no voting rights, while other firms have provided some modest voting rights based primarily on the small capital contribution that they have made. Probably the trickiest area is whether or not an income partner is indemnified should there be a major lawsuit against the firm.

CPA PMF — When would (or could) an income partner have a higher compensation level than that of an equity partner?

Koltin — As mentioned above, we often see lateral partners coming in at higher compensation levels than some of the equity partners, as the firm has to pay the market-value wage in order to recruit that individual to the firm. For the most part, however, the average compensation of an equity partner is significantly higher than that of an income partner.

CPA PMF — Are there other types of partner structures besides that of income and equity partners?

Koltin — Yes. Many firms have developed a contract partner level, which essentially is for older partners who want to keep the title of "partner" but are nearing retirement. A lot of times this will happen with merged-in partners who want to practice for a couple of additional years, but both they and the firm want some type of alternative career track. Clearly this group of partners would not be eligible to become equity partners, as they have already been de-equitized as part of the merger process. They could also be receiving retirement benefits even though they are still practicing with the firm. We are also seeing many more permanent, part-time partners. Firms are much more focused on work/life balance — and, candidly, given the shortage of talent in the profession today, they've actually been happy to see certain partners extending their careers beyond the traditional retirement ages of 60 and 65. I think we are finding that today's 65 is much like 55, and we're seeing a reversal of such concepts as "mandatory retirement" and partners getting their gold watch and going off into the sunset.

CPA PMF — Has the movement from a one- to a two-tiered partnership created any other issues for firms?

Koltin — Probably the biggest change I've observed is the number of firms that have moved from open to closed compensation. That being said, the vast majority of firms typically find this move attractive once their net fees exceed $12 - $15 million. The rationale for this move is primarily to avoid the #1 partner controversy that exists in all firms — relative income. This issue, combined with a firm's greater willingness to enter into "free agency" and recruit lateral partners to the firm, has accelerated the number of firms moving to a closed compensation format.

CPA PMF — How have all of these changes impacted best-practice comparisons among firms?

Koltin — It has almost been humorous to watch various surveys in terms of how firms report their figures. I worked with a firm recently that told me that their average partner income had doubled and had gone from $250,000 to $500,000 per partner. In reviewing their figures it became apparent that the only change that occurred was that they had moved from a one- to a two-tiered partnership and now they were simply reporting only income per equity partner! It has also caused some firms to suggest that average partner income is now a meaningless term, because at some firms you'll have senior managers making more than other firms' income partners and at still other firms some of the income partners earning well beyond that of other firms' equity partners. Also, some firms have very stringent requirements for what it takes to become an equity partner, whereas other firms would tell you that this is an archaic term and all that really matters is what the individual makes and that they are happy with their earnings. Having said that, if we look at our counterparts in the legal profession, probably the #1 benchmark they look to is income per equity partner.

CPA PMF — Are there any other comments or thoughts you have on the topic?

Koltin — I think it was said best by Thomas Jefferson, who a couple of centuries ago said, "There is nothing more unequal than the equal treatment of unequal partners!" He not only hit the nail on the head, but he also defined then what would now become one of the biggest challenges for accounting firms worldwide.

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