CPA Management Essentials
Do Your Partner Agreements Include These Six Key Provisions?

by Gary Adamson

In my firm, the review and revision of partner agreements was a process that happened every ten to fifteen years, if that often. I think that is pretty common in most firms. The problem is that firms change and evolve as do the partners and the environments that we practice in. Our agreements need to keep pace with that change. I continue to be amazed at the number of firms that have no agreements at all or haven't made revisions in many years.

I want you to pull out your agreements, dust them off and read them. You might be surprised at what you see. Remember their primary purpose is to protect the firm and define the relationship between the firm and each partner. If you get motivated to update them, or create them, here are a few tips. I will preface this with the statement that I am not an attorney, this is not legal advice and you should consult an attorney in your state to help you.

Mandatory Retirement. I'm seeing this in most documents now. The point is that the firm should define the age at which normal retirement occurs. That means the individual's ownership interest is purchased at that time and the firm determines whether the individual may continue in any employment capacity. The retirement age is not important, although the trend is that it is increasing. The expected retirement date and the control by the firm over the process are important.

Notice and Client Transition. This provision is a relatively new one but I'm seeing it more. It goes hand in hand with mandatory retirement, discussed above. The concept is that there is an expectation by the firm that the individual partner will give reasonable notice and enter into a plan to transition his or her clients over a period of time before retirement or voluntary separation from the firm. If you have ever had a partner leave the firm on short notice or a retiring partner who just won't let go (I know that never happens in your firm) you know how tough it is to retain the clients. Let's face it, if we lose a number of the partner's clients because of poor transition it's pretty tough to write those retirement checks. Put some teeth in your agreement to assure a smooth and successful transition.

Caps on Retirement Benefits. The discussion of how to determine the amount of retirement or deferred comp benefits for your firm is beyond the scope of this article. Regardless of how you get to the benefit amount, every agreement should include a provision to cap the total retirement benefits that can be paid out in any one year. You really have to balance the desires of the retiring generation with the younger generation who will be paying out the old guys. Generally it is a function of the firm's gross revenue or profits before partner comp. I've seen numbers ranging from 10% of profits to 10% of gross revenue. You have to decide what is right for your firm.

Competition Provisions. This one is very much influenced by the laws in your state(s) of practice and you need to know how the courts view non-compete restrictions. I can tell you that the trend for firms in many states is definitely away from a prohibition of competition with the associated injunctive relief provisions. The movement is toward the concept of payment for clients that are taken from the firm for some period of time based on a multiple of billings. One year of billing seems to be fairly prevalent. Be careful not to offset deferred compensation

payments to a partner against payment for clients as you may run afoul of IRS Code Section 409(a).

Vesting. The concept of retirement benefit vesting shows up in a couple of different ways in partner agreements. One is the "years of service" factor where the firm puts a value on tenure and contribution to the success of the firm over the long haul. An example here could be a twenty five year scale with full vesting at the twenty five year mark. The second is an age factor that ties into the firm's mandatory retirement age, discussed earlier. This one is generally expressed in terms of a discount or penalty for every year that the exiting partner's age is short of the target. For example, I have seen plans that discount the retirement payments by 2.5% for each year short of age 65. Many firms utilize a combination of both the years of service and age vesting factors.

Dispute Resolution. I'm seeing more and more partner agreements include language to require that any dispute surrounding them be settled by arbitration rather than through the courts. It can be more expeditious to go this route and it can also be a preferred choice for the firm over a possible jury trial. The American Arbitration Association is the body that is often referenced. Again, consult with an attorney in your state for specifics and whether these general statements apply to you.

Gary Adamson is the President of Adamson Advisory, specializing in practice management consulting for CPA firms. He is an Indiana University graduate and has extensive hands on experience as the recent managing partner of a top 200 CPA firm. He can be reached at (765)488.0691 or gadamson@adamsonadvisory.com. For more about Adamson Advisory, visit www.adamsonadvisory.com or follow the company at www.adamsonadvisory.com/blog and www.twitter.com/adamsonadvisory.