Admitting Income Partners

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Strong growth, retention challenges, and the changing face of accounting firm hires have led to increased discussion around the potential role of income partners in a firm.

> *Although adding an income partner role may seem like an easy solution, this change comes with challenges and unique considerations.*

Let's candidly discuss the benefits, potential pitfalls, and best practices when adding income partners to your firm's structure.

Benefits of Adding Income Partners

Any change requires a clear understanding of the benefits to ensure the gain is worth the effort. Some of the typical benefits firms experience from adding income partners:

1. **Improves the retention of good people**. How do we know this? Generally speaking, people are no longer a flight risk when they reach partner level. Advancing someone from senior manager to income partner is an excellent way to retain them in the firm.

2. **Allows greater flexibility when merging in or acquiring smaller firms**. It's not uncommon to find that individuals in a small firm you've acquired are not performing at the same level as your current equity partners.

3. **Gives you the ability allow someone more time, while offering a partner position.** A quality individual may need additional time to develop into an equity partner or may never attain the equity partner level.

4. **Helps the firm avoid becoming over-partnered.** It's not uncommon for firms to feel reluctant to promote their up-and-coming managers and senior managers to partner, because they fear that the profit pool will be significantly weakened. The income partner-level allows for advancement in the firm without the simultaneous dilution of the profit pool.

5. **Creates a better fit for individuals who are maintainers rather than builders**. Many partners have developed much of the work they currently manage. They have been responsible for bringing in and retaining the clients they serve. Because of partner

retirements, many new partners in our profession receive most of their clients as transitions from retiring partners.

6. **Helps some senior managers with their business development efforts and results.** The ability to call yourself a partner and give someone a business card that says partner can increase your level of success in the marketplace.

7. **Provides part-time partner options when equity partner is not the right fit.** We are seeing an increase in the number of individuals who want to work reduced schedules for various reasons. Including income partner positions gives your firm a better option for introducing part-time partners.

8. **Maintains high requirements for equity partner admittance.** By adding income partners, you can ensure you don't diminish the status of the equity partner position. By creating income partners, the firm keeps the bar high for the equity partner role.

9. **Allows the opportunity to vet lateral partner hires.** An income partner designation provides the opportunity for both sides to test each other out and see if the anticipated fit works.

10. **Provides flexibility for older partners.** This added partner designation may work well for merged-in, retirement-minded partners and those headed towards or entering retirement, who may not want to commit to a full-time schedule, but still have value to offer the firm. In addition, the income partner position provides an alternative for individuals who would not have the time to vest in the partnership fully.

11. **Provides flexibility for younger partners.** Many younger people who have entered our profession during the past ten years have made it clear that they don't want to practice like the Baby Boomers have. There will likely be a future generation of partners who wish to work considerably less each year, but still have the potential to function as income partners.

Challenges to Expect

While there are many possible benefits to adding the income partner role, there are also pitfalls. Determine whether your reasons for adding this role could create some of these challenges.

1. **Risks lowering the bar for what it means to be a partner.** One managing partner stated, "the door only seems to swing one way – wider and wider – and we seem to become more tolerant each year of what it takes to be a partner in this firm." Ensure that

adding this new role doesn't lower what it takes to be a partner.

2. **May affect the culture of your partner meetings and retreats.** You may want to consider adding an equity partner-only session to meetings to maintain open and honest dialogue.

3. **May be viewed negatively.** If the income partner role creates another step in the path to partner, those who feel they have earned the right to be an equity partner and now have to wait to reach that level could be frustrated.

4. **Could create more confusion about the path to partner.** Many firms have created confusion by shrouding the path to partner in mystery. It may seem wise to introduce an income partner level, but leadership must also take the time to share the differences transparently.

5. **Could make a longer path to partner.** The firm may risk losing bright young stars who see so many people above them that the path to partner seems heavily congested and probably longer than they care to traverse.

6. **May encourage a top-heavy firm.** For years, firm leaders have discussed the need to be structured more like a pyramid. This new designation does more to promote top-heaviness than discourage it.

Questions to Bring Clarity

Not every firm will experience the same benefits and challenges. Some questions to help you determine the impact of adding an income partner role to your firm include:

- Do individuals need to be income partners before becoming equity partners?
- What positions of leadership can income partners hold?
- What internal and external announcements will occur when introducing an income partner?
- Is there clarity around what it takes to become an income or equity partner?
- Can income partners be part-time partners? If so, what percentage of full-time will be allowed?
- Who should know about the different partner levels, and how should this be communicated?

Before adding this designation, you also need to determine the selection process. Key questions to consider include:

- Who can select new income partner candidates?
- If a vote of the partner group is required, what percentage is required to welcome new income partners?
- What is the required amount of capital buy-in from income owners?
- What is needed to terminate an income partner?
- Do income owners receive the same package of benefits as equity owners?

Next, you need to decide the rights and responsibilities of income partners. Questions include:

- Will income partners be given the same annual reviews as equity partners?
- What are the compensation structure and bonus pool for income partners?
- Will income partners have a deferred comp plan?
- Will income partners have a sabbatical program?
- Are income partners allowed to purchase ownership in related business entities?
- Are income partners allowed to purchase ownership in firm offices?

Good communication becomes vital when introducing a new role in the firm, especially a new category of partners. Starting with the questions above is a significant first step.

From there, answering questions from existing partners is critical. Based on what adding an income partner looks like in your firm, you'll also need to anticipate questions from other key players in the firm.

Your ability to remove the mystery and communicate clearly will directly impact your ability to add this new role successfully.

Example Guidance

Implementing an income partner role will look different at each firm. Below is an example of how one firm in our profession communicated to their partner group the differences between income partner and equity partner.

Rights and Responsibilities

	Income Partner	Equity Partner
Experience	Demonstrate proven success in a principal role within our firm for at least one year, or function in an equivalent role in another organization	Demonstrate proven success in a non-equity partner role within our firm for at least one year, or function in an equivalent role in another organization
Revenue *(for client service candidates)*	Demonstrate proven success to manage $500,000 or greater in annual revenue for a year prior to Partner admission	Demonstrate proven success to manage $850,000 or greater in annual revenue and the ability to transfer work to other Partners and Principals
Business Development	Demonstrate $50,000 or more of business development efforts	Demonstrate $250,000 or more of business development efforts
Client Satisfaction *(for client service candidates)*	Demonstrate client satisfaction with client survey's averaging 8.5 or greater	Demonstrate client satisfaction with client survey's averaging 8.5 or greater
Margins *(for client service candidates)*	Demonstrate comparable partner margins within his/her practice area	Demonstrate comparable partner margins within his/her practice area
Professional Excellence *(for client service candidates)*	Demonstrate professional excellence by achieving an average PED score equal to or better than the firm's average	Demonstrate professional excellence by achieving an average PED score equal to or better than the firm's average
Partner Commitment	Commit to, follow and live the Partner Commitment	Commit to, follow and live the Partner Commitment

Leadership Opportunities

	Income Partner	Equity Partner
Firm Committee (Audit, Budget, etc.)	Eligible	Eligible
Team Leader	Eligible	Eligible
Practice Leader	Eligible	Eligible
Office Managing Partner	Eligible	Eligible
Board of Directors	Not Eligible	Eligible
Management/Comp. Committee	Not Eligible	Eligible

Voting Rights

	Income Partner	Equity Partner
Election of New Non-Equity Partners	No vote	1 vote per Equity Partner
Dismissal of Non-Equity Partners	No vote	Approval of the Board of Directors
Election of New Equity Partners	No vote	1 vote per Equity Partner
Dismissal of Equity Partners	No vote	1 vote per Equity Partner
Election of Firm Board Members	1 vote per Non-Equity Partner	1 vote per Equity Partner
Mergers over 10% current revenue	No Vote	1 vote per Equity Partner
Vote to sell the accounting firm	No vote	1 vote per Equity Partner
Election of the CEO	No vote	1 vote per Equity Partner

Compensation

	Income Partner	Equity Partner
Draw	Set by the Compensation Committee	Set by the Compensation Committee
Firm Provided Benefits	Same for Equity & Non-Equity	Same for Equity & Non-Equity
Capital Buy In	None, but will build up limited Equity account through capital bonus allocations	$100,000
Bonus	Set by the Compensation Committee	Set by the Compensation Committee
Referrals from Subs / Affiliates	Same policy for both Equity and Non-Equity Partners	Same policy for both Equity and Non-Equity Partners
Retirement / Deferred Compensation	6% of compensation annually while employed by the firm. Vested at age 62. No payments after retirement.	Same as current policy

Work Commitment

	Non-Equity Partner	Equity Partner
Full time / Part time	75% - 100% Full Time	100% Full Time

For more information on best practices related to implementing the income partner role at your firm,, please contact us at info@upstreamacademy.com