The Elements of a Successful Architectural Firm

Presented by: Shimmerman Penn LLP

May 9, 2013
Our AED Specialist Team

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Our AED Industry Group

Dedicated team serving the industry for 20+ years. Educational programs, webinars and events. Conference presentations at OAA, IIDEX, SDA Canada. Assisted the OAA in drafting proposed changes to the Architects Act in 2010.

Key areas of focus include:

• Structuring new business partnerships
• Understanding common industry valuation methodologies
• Creating succession plans for organic growth
• Financial benchmarking using key industry metrics
• Designing creative compensation strategies
Elements of a Successful Architectural Firm

- Ownership Structures
- Understanding the Value of the Firm
- Financial Benchmarking and Metrics
- Enhancing the Value of the Firm
- Effective Compensation Strategies
About Shimmerman Penn LLP

• Established in 1979
• We are entrepreneurial minded – not just your typical accountants!
• We strive to gain a full understanding of your business, your goals and challenges
• We build long-term relationships with our clients based on trust and integrity
Our Services

- Accounting and assurance
- Taxation compliance and planning
- Business advisory:
  - Corporate structure – financial and tax
  - Succession planning
  - Personal financial and tax planning
  - Estate planning
The Elements of a Successful Architectural Firm

Ownership
Structures

May 9, 2013
Ownership Structures

Architects Act

- A corporation may be issued a Certificate of Practice if at least 51% of the voting shares and 51% of the value of all shares of the corporation is directly or indirectly controlled and owned by members of the OAA, or members of the OAA and members of the Professional Engineers of Ontario (PEO).

- **Indirect ownership** means that any shareholder of a corporation that holds a Certificate of Practice may hold their shares through a Holding Company.

- A **majority of the directors** of the corporation holding a Certificate of Practice must be comprised of members of the OAA, the PEO or both the OAA and PEO.
Architects Act

- A general partnership may be issued a Certificate of Practice if **at least 51% of the voting interests** and **51% of the financial interests** in the partnership is **directly or indirectly** held by members of the OAA, members of the PEO, or members of the OAA and PEO

- **Voting interest**: where a vote is taken by the partners, the percentage of that vote which is held by members

- **Financial interest**: the monetary value of the ownership units of the partnership that is held by members

- **Indirect ownership**: any partner of a partnership that holds a Certificate of Practice may hold their partnership interest using a Holding Company
Ownership Structures

Corporate Structure

Architect 1
Architect 2
Architect 3

Architect Firm
Ownership Structures

Corporate Structure

- Architect 1
- Architect 2
- Architect 3

Holdco 1

Architect Firm
Ownership Structures

Corporate Structure

- Architect 1
  - Holdco 1

- Non-Architect 3
  - Holdco 3

- Architect 2
  - Holdco 2

- Family Trust
  - Architect Firm
Corporate Structure

- Advantages of a holding company structure
  1) Potential tax savings
  2) Potential tax deferral
  3) Enhance a succession plan
  4) Trusts can fund dependants education and income splitting
Relationship Between Personal and Corporate Tax Rates
Two Levels of Tax

- At some point an individual shareholder of a corporation will desire funds from the corporation for personal use.
- The payment of after-tax corporate funds to an individual shareholder is taxable as a dividend to the individual.
- Therefore, income earned by a corporation is taxed twice:
  1. When earned by the corporation
  2. When distributed to the individual.
- Dividends to connected (>10% votes and value) corporate shareholders are tax free.
- Dividend distributions to individual shareholders are taxed at preferential rates.
Ownership Structures

### Combined Tax Rates on Business Income

<table>
<thead>
<tr>
<th>Description</th>
<th>First $500,000</th>
<th>General corporate rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012 corporate tax rate</td>
<td>15.5%</td>
<td>26.5%</td>
</tr>
<tr>
<td>Income earned</td>
<td>$ 100</td>
<td>$ 100</td>
</tr>
<tr>
<td>Corporate tax paid</td>
<td>($ 16)</td>
<td>($ 27)</td>
</tr>
<tr>
<td><strong>After-tax corporate earnings</strong></td>
<td>$ 84</td>
<td>$ 73</td>
</tr>
<tr>
<td>Taxable dividend</td>
<td>$ 84</td>
<td>$ 73</td>
</tr>
<tr>
<td>Personal tax paid</td>
<td>($ 27)</td>
<td>($ 22)</td>
</tr>
<tr>
<td><strong>After-tax personal earnings</strong></td>
<td>$ 57</td>
<td>$ 51</td>
</tr>
<tr>
<td><strong>After-tax personal earnings with no corporation (46.41% tax)</strong></td>
<td>$ 54</td>
<td>$ 54</td>
</tr>
<tr>
<td><strong>Tax savings (cost)</strong></td>
<td>$ 3</td>
<td>($ 3)</td>
</tr>
</tbody>
</table>
Ownership Structures

Potential Tax Savings

Architect Firm

Holdco 1

Architect

Firm earns $100,000
After tax earnings = $84,500

Firm pays dividend to Holdco of $84,500 – no tax

Holdco pays dividend to shareholder
Net After Tax = $57,000

Firm earns $100,000
After tax earnings = $84,500
### Potential Tax Deferral

<table>
<thead>
<tr>
<th>Description</th>
<th>15.50%</th>
<th>26.5%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate tax rate</td>
<td>15.50%</td>
<td>26.5%</td>
</tr>
<tr>
<td>Income earned</td>
<td>$ 100</td>
<td>$ 100</td>
</tr>
<tr>
<td>Corporate tax paid</td>
<td>($ 16)</td>
<td>($ 27)</td>
</tr>
<tr>
<td>Corporate after-tax earnings (A)</td>
<td>$ 84</td>
<td>$ 73</td>
</tr>
<tr>
<td>After-tax personal earnings with no corporation (B)</td>
<td>$ 54</td>
<td>$ 54</td>
</tr>
<tr>
<td>Potential tax deferral (A-B)</td>
<td>$ 30</td>
<td>$ 19</td>
</tr>
</tbody>
</table>
Ownership Structures

Potential Tax Deferral

Architect

Holdco 1

Architect Firm

Holdco pays dividend to shareholder of $60,000

Firm pays dividend to Holdco of $84,500 – no tax

Firm earns $100,000
After tax earnings = $84,500

Holdco retains $24,500 of cash – defers $7,800 in taxes

Firm earns $100,000
After tax earnings = $84,500

Holdco 1
Firm earns $100,000
After tax earnings = $84,500

Holdco pays dividend to Holdco
(50%) of $42,250 – no tax

Holdco pays dividend to shareholder of $32,250

Holdco retains $10,000 of cash and pays down debt – $3,100 of additional $ to pay debt

Firm pays dividend to Holdco
(50%) of $42,250 – no tax

Enhance A Succession Plan

Ownership Structures
Ownership Structures

Fund Dependant Education and Income Splitting

Architect Firm

Firm earns $100,000

After tax earnings = $84,500

Firm pays dividend to Holdco

Of $84,500 – no tax

Holdco pays dividend to shareholder

Of $60,000

Holdco pays Trust dividend of $24,500

Dividends paid to beneficiaries. If no other income, dividend will be tax free

Architect

Firm earns $100,000

After tax earnings = $84,500

Holdco 1

Family Trust

Family Trust

Architect Fund Dependant Education and Income Splitting
Ownership Structures

Partnership Structure

Architect 1

Architect 2

Architect 3

Architect Firm
Ownership Structures

Partnership Structure

- Architect 1
- Corporate Partner 1

- Architect 2
- Corporate Partner 2

- Non-Architect
- Corporate Partner 3

Architect Firm
The Elements of a Successful Architectural Firm

May 9, 2013
Financial Benchmarking and Metrics

General Principles

• Which ones to use

• What information they provide
  – Performance
  – Efficiency
  – Predictive
Financial Benchmarking and Metrics

**Performance Metrics**

- Total fees or Net fees
- Gross margin
- Operating profit
- Net fee multiplier
- Profit on net fees
- Net revenue growth
Performance Metrics – Net Fee Multiplier

- Net fees / Total labour costs
- Net fees is the total fees less consultants
- Direct labour costs includes:
  - Total professional staff salaries
  - Contract labour (freelancers)
Financial Benchmarking and Metrics

Net Fee Multiplier

<table>
<thead>
<tr>
<th>Year</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>High</td>
<td>3.68</td>
<td>2.89</td>
<td>2.62</td>
<td>3.12</td>
<td>2.53</td>
<td>3.05</td>
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<tr>
<td>Low</td>
<td>1.61</td>
<td>1.82</td>
<td>1.56</td>
<td>1.47</td>
<td>1.52</td>
<td>1.44</td>
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<tr>
<td>Average</td>
<td>2.20</td>
<td>2.20</td>
<td>2.04</td>
<td>2.09</td>
<td>1.99</td>
<td>2.07</td>
</tr>
</tbody>
</table>
Performance Metrics - Profit on Net Fees

- Profit / Net fees
- Profit before income taxes
- Adjust for profit sharing bonuses and other non-routine adjustments
Financial Benchmarking and Metrics

Profit on Net Fees

<table>
<thead>
<tr>
<th>Year</th>
<th>High</th>
<th>Low</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>48.17%</td>
<td>7.85%</td>
<td>25.72%</td>
</tr>
<tr>
<td>2008</td>
<td>46.84%</td>
<td>12.46%</td>
<td>23.49%</td>
</tr>
<tr>
<td>2009</td>
<td>42.08%</td>
<td>1.93%</td>
<td>18.84%</td>
</tr>
<tr>
<td>2010</td>
<td>54.88%</td>
<td>3.26%</td>
<td>21.49%</td>
</tr>
<tr>
<td>2011</td>
<td>42.73%</td>
<td>7.66%</td>
<td>20.11%</td>
</tr>
<tr>
<td>2012</td>
<td>55.51%</td>
<td>2.59%</td>
<td>18.94%</td>
</tr>
</tbody>
</table>
**Efficiency Metrics**

- Profit per project
- Net revenue per total staff
- Overhead rate
- Utilization rate
- Utilization Multiplier or Revenue Factor
Efficiency Metrics - Overhead Rate

- Total overhead / Total labour costs
- Operating costs not project specific
- High overhead structure requires maintaining a certain billings target
Financial Benchmarking and Metrics

Overhead Rate

<table>
<thead>
<tr>
<th>Year</th>
<th>High</th>
<th>Low</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>90.58%</td>
<td>26.52%</td>
<td>58.50%</td>
</tr>
<tr>
<td>2008</td>
<td>89.83%</td>
<td>32.96%</td>
<td>65.69%</td>
</tr>
<tr>
<td>2009</td>
<td>86.09%</td>
<td>35.39%</td>
<td>63.39%</td>
</tr>
<tr>
<td>2010</td>
<td>83.64%</td>
<td>32.92%</td>
<td>60.72%</td>
</tr>
<tr>
<td>2011</td>
<td>94.26%</td>
<td>41.47%</td>
<td>63.29%</td>
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<tr>
<td>2012</td>
<td>92.45%</td>
<td>35.63%</td>
<td>67.08%</td>
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</tbody>
</table>
Efficiency Metrics - Utilization Rate

- Direct labour / Total professional labour
- Use dollars, not labour hours
Financial Benchmarking and Metrics

**Predictive Metrics**
- Contract Backlog
- Hit Ratio or Proposal win rate
- Bid & Proposal costs as a percentage of total contract value of bids
Net Fee Multiplier by:

- Project Type
  - P3 vs non-P3

- Industry Sector

- Service Discipline
Financial Benchmarking and Metrics

Budgeting Function

Net Fee Multiplier Matrix
to Determine Project Fees
## Financial Benchmarking and Metrics

### Budgeting Function

<table>
<thead>
<tr>
<th>Net Fee Allocation</th>
<th>72.76%</th>
<th>70.26%</th>
<th>67.76%</th>
<th>65.26%</th>
<th>62.76%</th>
<th>60.26%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Professional Salaries</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Overhead</td>
<td>24.74%</td>
<td>24.74%</td>
<td>24.74%</td>
<td>24.74%</td>
<td>24.74%</td>
<td>24.74%</td>
</tr>
<tr>
<td>Required Profit</td>
<td>2.50%</td>
<td>5.00%</td>
<td>7.50%</td>
<td>10.00%</td>
<td>12.50%</td>
<td>15.00%</td>
</tr>
<tr>
<td></td>
<td>100.00%</td>
<td>100.00%</td>
<td>100.00%</td>
<td>100.00%</td>
<td>100.00%</td>
<td>100.00%</td>
</tr>
<tr>
<td>Overall Net Fee Multiplier required</td>
<td>1.37</td>
<td>1.42</td>
<td>1.48</td>
<td>1.53</td>
<td>1.59</td>
<td>1.66</td>
</tr>
<tr>
<td>Net Fee Multiplier at project level</td>
<td>1.76</td>
<td>1.82</td>
<td>1.90</td>
<td>1.97</td>
<td>2.04</td>
<td>2.13</td>
</tr>
</tbody>
</table>
Financial Benchmarking and Metrics

Conclusion

- Focus on a select number
- Balanced set
- Understand and react
- Develop a reporting process
The Elements of a Successful Architectural Firm

May 9, 2013
Value of the Business

General Principles

• Understanding the “value” of your business – what it’s worth
• Planning for ownership transition – what is the purpose of the valuation
  – Internal succession
  – Mergers and acquisitions
  – Sale of the firm
• Potential of the firm to fund its internal succession
Value of the Business

Common Valuation Techniques

• Formal valuation
• Comparable firm valuation
• Determined by owners
• Specific formula
Value of the Business

Methodology and Formula for Architecture Firms

- Combination of Book Value and Earnings
- “Value” = Book value + Goodwill
- Goodwill based on a “Multiple of Earnings” formula
Value of the Business

Valuation Formula: Book Value

Book Value

- Assets less Liabilities – per financial statements
  - Corporations – Shareholders’ Equity
  - Partnerships – Partners’ Capital
- Operating assets and liabilities (working capital)
- Capital/Fixed Assets
- Investments
- Income tax effects
- Contingencies
Value of the Business

Valuation Formula: Goodwill and Earnings

Earnings: Profits from Operations
- Reliability of earnings
- Stability of earnings
- Earnings trend
- Significant risk factors
- Corporate identity separate from individuals
- Market trends within specific niches
- Contract backlog and proposals
Value of the Business

Valuation Formula: Goodwill

Goodwill: The Business Advantage

- Reputation
- Clients and retention
- Specialization
- Technical skills
- Firm management
- Probability the business advantage will continue
- Potential of increased profitability
- Professional staff team, retention
- Transferability of Goodwill
Value of the Business

**Goodwill Formula: Earnings x Multiple**

Earnings base
- Earnings before income tax from financial statements

“Normalized” pre-tax earnings
- Adjust earnings for unusual non-recurring events
- Items not part of ordinary operations
- Set appropriate level of owner remuneration

Average of recent years’ normalized earnings
- Generally 3-5 years
- Consider weighted average

Multiple to be used
- Indication of confidence and risk
- Ranging from 1.5 to 4 times normalized pre-tax earnings
Example: Normalized Earnings

<table>
<thead>
<tr>
<th></th>
<th>2012</th>
<th>2011</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Earnings before income taxes</td>
<td>$ 200,000</td>
<td>$ 225,000</td>
<td>$250,000</td>
</tr>
<tr>
<td>per financial statements</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjustments:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Year end profit sharing bonuses</td>
<td>$ 250,000</td>
<td>$ 300,000</td>
<td>$100,000</td>
</tr>
<tr>
<td>Secondary office closing</td>
<td></td>
<td></td>
<td>$ 50,000</td>
</tr>
<tr>
<td>Moving expenses</td>
<td></td>
<td>$ 75,000</td>
<td></td>
</tr>
<tr>
<td>Bad debt</td>
<td>$ 50,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Normalized earnings before</td>
<td>$ 500,000</td>
<td>$ 600,000</td>
<td>$400,000</td>
</tr>
<tr>
<td>income taxes</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Value of the Business

Example: Valuation Formula

3X Multiple of a 3-year average of normalized pre-tax earnings + Book Value

ABC ARCHITECTS LIMITED

<table>
<thead>
<tr>
<th></th>
<th>2012</th>
<th>2011</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Normalized earnings before income taxes</td>
<td>$500,000</td>
<td>$600,000</td>
<td>$400,000</td>
</tr>
<tr>
<td>Average earnings before income taxes (3 years)</td>
<td>$500,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Earnings Multiple</td>
<td>3.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Goodwill</td>
<td>$1,500,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Book Value of ABC Architects Limited</td>
<td>$ 300,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Value of firm</td>
<td>$1,800,000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Value of the Business

Keep Current on Valuation

- Update your ownership agreement
- Calculate annually
- Keep score
- Compare
- Reality check
- Be prepared for opportunities or challenges
The Elements of a Successful Architectural Firm

May 9, 2013
Overview

• Focus on improving the 2 components of value
  – Book Value
    • using financial metrics to improve the quality of the firm’s assets
  – Goodwill:
    • Quantitative: focus on the quality of earnings
    • Qualitative: increasing the value of “goodwill”

• Assess the changing marketplace
• Strategic planning: consider your options for growth
• Impact of your firm’s leadership model and culture on value
Enhancing the Value of the Firm

Improving the Quality of Assets

- Metrics provide feedback for decision making
- Healthy balance sheet = lower risk, greater value, greater advantage
- Working capital and liquidity: billings and collections
- Cash flow management
- Investment in technology and physical resources
- Retaining a capital base in the firm
- Impact of financing
Enhancing the Value of the Firm

Improving the Quality of Earnings

• Project management, staff satisfaction and retention
• Practice efficiency and effectiveness
• Matrix for tracking performance
  – business segments
  – Industry sectors
  – project teams
• Tracking the “cost” of pursuits, win rates
• Feedback for fee budgets
• Managing overhead costs
• Level of discretionary spending
Enhancing the Value of the Firm

**Goodwill: Market factors**

- Market segments
- Niche services
- Current market conditions
- Economic outlook for the firm’s services – 5 year?
- Concentration risk: Market, client
- Annuity vs. one-off projects
- Relationships with contractors and other professionals
- Reliance on government funding
- Foreign markets: external risks
Marketplace is Changing

- Develop new services and specialties in-house
- Leverage a broader based firm
- Collaboration among firms to win projects
- International business opportunities
- Public-private-partnerships (P3)
- Mergers and acquisitions
- Access to talent, technologies, markets, services
- Access to outside investors
- Recent amendments to the Architects Act (Ontario) permit broader ownership of architecture firms
Enhancing the Value of the Firm

Leadership and Culture

Firm Culture: all of the human qualities that characterize a firm, the teams of people working together, the environment that reflects the values, commitments and attitudes of the people.

- Culture has a direct impact on value
- Challenge of balancing quality of design vs. profitability
- Foster a firm whose culture offers recognition and rewards, mentorship, and opportunities for growth and development.
- Active process of identifying and developing new owners and the firm’s future leaders
- Consultants can provide valuable assistance in leadership development
Leadership and Culture

• A firm’s size affects its culture
• Firms choose to keep their practices a particular size to gain advantages of a specific culture.
• Size influences how closely the principals can control design, how employees work, which projects the firm takes on.
Leadership and Culture

- Smaller firms (<6 owners) often have a collaborative approach to leadership with broad participation by the owners, and management by committee.
- Owners participation evolves with the succession plan
- Limited number of teams
- Employees work with many principals, on many projects
Leadership and Culture

• In larger firms, leadership is more concentrated, in a managing partner or executive committee.
• Large firms often organize themselves in ways that allow them to function as multiple internal businesses, to achieve the cultural benefits of smaller and larger size.
• Studio system of organization where a team follows a project from beginning to end under the guidance of a leader.
Enhancing the Value of the Firm

Mentorship Programs

• OAA Perspectives Spring 2013 issue
• Historical tradition in the profession
• Appropriate in any size firm
• Helps identify future leaders and develop the skills of the team = increased value
• Process of transfer of skills and insights
• Aligned with the concept of transferring Goodwill
• Reduces overall professional liability risk
The Elements of a Successful Architectural Firm

May 9, 2013
Overview

• Elements of effective compensation systems
• Performance criteria and goals
• Components of remuneration
• Impact of ownership structure on remuneration
• Compensation strategies for key employees
Effective Compensation Strategies

Elements of an Effective Compensation System

• Alignment with the firm’s strategic planning and goals
• Enable the firm to service its clients
• Motivate needed behaviors
• Encourage effective workflow
• Drive firm profitability…increase “value”
• Create trust – people trust the decision makers
• Flexible approach
• Performance based
• Include objective and subjective performance criteria
• Criteria clearly defined and communicated
Effective Compensation Strategies

Elements of an Effective Compensation System

• Who decides:
  ‒ Compensation committee
  ‒ Group decides
  ‒ Leader decides

• Evaluation criteria
  ‒ Qualitative and quantitative factors
  ‒ Formula based and discretionary component
  ‒ Tied to firm goals: eg. revenue generation, profitability

• Annual goal setting for owners
• Periodic feedback on performance
Effective Compensation Strategies

**Performance Criteria**

- Leadership
- People skills
- Staff development and mentorship
- Practice development
- Client transition
- Traditional production measures (quantitative)
- Technical skills, specialization
- Client service and retention
- Teamwork
- Good citizenship – being a “good” partner/principal
Effective Compensation Strategies

Performance Goals

Qualitative Goals:
• Teamwork with owners
• Mentoring and training staff
• Delegating to staff
• Client and relationships and retention
• Industry contacts and exposure
• Technical expertise
• Business development efforts
• Following the rules, meeting responsibilities, responding to requests.
Effective Compensation Strategies

Performance Goals

Quantitative Goals:
• New business originated
• Repeat client work
• Managed client relationships
• Billable hours
• Realization on projects
• Aging of Accounts Receivable and Work-In-Progress
• Business transitioned
Effective Compensation Strategies

Components of Remuneration

- "Base Level" Compensation for Work Performed
- Performance Bonus
- Profit Sharing Bonus
Effective Compensation Strategies

Components of Remuneration

1. Compensation for work performed
   - Base level compensation earned by owners who are active in the firm, and employees
   - May be equal or tiered for owners, based on specific factors (e.g., number of years with the firm)
   - Related to industry norms

2. Performance bonus
   - Earned by owners who are active in the firm, and employees, based on established criteria and goals, with some discretion for the allocation.

3. Profit Sharing bonus
   - Earned by owners only – a benefit of ownership
   - Equity participation
   - Allocation to owners proportionate to ownership %
Effective Compensation Strategies

Components of Remuneration: Example

Facts
• Firm has 4 owners, all active in the firm
• Base level compensation for each owner is $100,000
• Basis for determining bonus pool is “profit on net fees”
• Profits are calculated net of the base level compensation
• Firm will retain 2% of net fees annually, to build capital
• Staff bonus pool = next 2% of net fees
• Owner performance pool = next 4% of net fees
• Profit-sharing pool = excess over 8% of net fees

Two scenarios presented:
• Annual profits = 12% of net fees
• Annual profits = 6% of net fees
**Effective Compensation Strategies**

### Components of Remuneration: Example

**FIRM PERFORMANCE**

<table>
<thead>
<tr>
<th></th>
<th>Scenario 1</th>
<th>Scenario 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net fees</td>
<td>$2,500,000</td>
<td>$2,500,000</td>
</tr>
<tr>
<td>Profit on net fees (12%) (6%)</td>
<td>$300,000</td>
<td>$150,000</td>
</tr>
<tr>
<td>Profit retained (2%)</td>
<td>$50,000</td>
<td>$50,000</td>
</tr>
<tr>
<td>Performance pool - staff (2%)</td>
<td>$50,000</td>
<td>$50,000</td>
</tr>
<tr>
<td>Performance pool - owners (to 8%)</td>
<td>$100,000</td>
<td>$50,000</td>
</tr>
<tr>
<td>Profit sharing pool - remainder</td>
<td>$100,000</td>
<td>$0</td>
</tr>
</tbody>
</table>

**OWNER REMUNERATION**

<table>
<thead>
<tr>
<th></th>
<th>Scenario 1</th>
<th>Scenario 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Base: 4 owners @ $100,000</td>
<td>$400,000</td>
<td>$400,000</td>
</tr>
<tr>
<td>Performance – based on criteria</td>
<td>$100,000</td>
<td>$50,000</td>
</tr>
<tr>
<td>Profit sharing – based on owner %</td>
<td>$100,000</td>
<td>$0</td>
</tr>
</tbody>
</table>

**TOTAL OWNER REMUNERATION**

<table>
<thead>
<tr>
<th></th>
<th>Scenario 1</th>
<th>Scenario 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>$600,000</td>
<td>$450,000</td>
<td></td>
</tr>
</tbody>
</table>
Effective Compensation Strategies

Effects of Ownership Structure

Corporation
- Salaries plus bonuses are paid to architect-shareholders.
- Bonuses may include performance and profit sharing components.
- A portion may be distributed as dividends, with a potential tax-free distribution to individual holding companies.
- Shareholders may use individual holding companies to defer tax and split income among family members through the payment of dividends.
- Corporations allow the use of stock option benefits for new owners.

Partnership
- Profits are allocated to the partners at the end of the year, based on an agreed allocation, possibly using a tiered approach of base plus bonus draws.
- Individual partners record their share of annual profits in their personal income tax returns.
- Partners may use individual companies to defer tax and split income among family members through the payment of dividends. The partner may also draw a salary from the company.
Effective Compensation Strategies

Compensation of Employees

• Enhanced compensation of key employees who are not currently owners in the firm
• Establish benefits for these individuals that are similar to ownership
  – Profit sharing plan
  – Phantom ownership plan
• Employee stock options
• Employee benefits and “perks”
Elements of a Successful Architectural Firm

- Ownership Structures
- Understanding the Value of the Firm
- Effective Compensation Strategies
- Financial Benchmarking and Metrics
- Enhancing the Value of the Firm
spllp.com
Elements of a Successful Architectural Firm

2013 Presentation by Shimmerman Penn LLP

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