



# Ready to Merge?

*That's the question facing many CPA practices...trust your instincts to find the right answer. By Joel Sinkin and Max Krotman*

**HOW CAN YOU WORK LESS, MAKE MORE** and do the work that you like, all while assuring your payout on retirement? For accountants across the nation, the answer is merge, merge, merge.

**Division of labor** If you're like other finance professionals, chances are you're conducting audits, business management projects and SEC work, and providing investment advisory, financial planning and mass-market tax return services...and more. You're doing partner, senior manager and junior-level work—even emptying the trashcan and making copies.

Keep in mind that you make money by doing what you know best, and by letting someone else do the rest. Mergers provide a means for you to do just that. But how do you piece together the right people and terms?

**Buy into technology.** Technology can allow you to work more efficiently and maintain your fees, while also increasing your hourly rate. You also can substantially cut subordinates' labor hours or eliminate excess staff. What is more, improved technology may enable lower-cost staff members to handle work previously performed by a partner, freeing that partner to develop new clients and/or bill additional hours.

**Develop a niche.** QuickBooks and inexpensive 1040 programs have eclipsed the typical accounting practice of the past. Accountants now sell expertise, not elbow grease, and the most profitable expertise is found in niches, which can range from focus reports for broker-dealers to specialization in financial services, IT, litigation support, etc. Accounting firms can choose between training and certifying their own members in these fields, or bringing in pre-trained new members through mergers or acquisitions.

**Hire competent staff.** Although they're easier to find now than they were five years ago, it's still a major challenge to hire, train and retain competent, profitable staff. Firms merge to increase their talent pool and to create an atmosphere in which they can develop and retain qualified people. The merged firm is more profitable and can pay higher wages. Higher profits per partner also create a desire among younger staff members to stay and reach the top.

**Secure your succession.** There are far fewer competent 30- to 40-year-old CPAs than there were 30 years ago. The solution is to maximize technology and staff through a merger, so you can sustain the practice and pay off the retiring "senior partners." Those retirement age partners also may prefer to work part time. Using this strategy allows Baby Boomers to realize the value they have built into their practices, despite the lack of established internal succession.

**Sell to a consolidator.** Lately, the bloom has been off this rose, but sales to consolidators may become a more popular option in the future. One of the major goals of the consolidation movement was to establish cross-selling opportunities, and accounting firms have learned a valuable lesson about the power and influence that consolidators wield over their clients.

**What's your practice worth?** Practically speaking, your practice is worth the profits your buyer or successor can realize from it.

External sales for practices typically are discussed as a multiple of billings. But there is no magic to a multiple—it varies from deal to deal. Price and terms are best analyzed in terms of these five variables:

1. **Cash upfront:** Seventy-five percent of accounting transactions have some cash advanced at closing. Once in a blue moon, sellers will take a huge discount for an all-cash deal, but most buyers will run when a seller agrees to a 50-percent discount for cash, assuming the practice must be bogus to take a 50-percent hit on day one.
2. **Retention period:** Most practices are priced at a percentage of collections. Buying accountants prize certainty. Most are willing to overpay for the practice as long as they are sharing the profits. They are risk averse in the truest sense, but are generous with profits.
3. **Profitability:** Price is determined by the net profit a successor will realize. This includes areas such as billing rates, type of work, growth potential and payout tax ramifications.
4. **Duration of the payout period:** Most firms would prefer to pay 20 percent of collections for seven years, rather than 33 percent for three years. The typical range of payout period is three to ten years.
5. **Multiple:** This can be measured only in the context of the four other variables. Longer payout and retention periods, and highly profitable acquisitions with less cash upfront, result in higher multiples.

There are no hard-and-fast methods for determining the worth of a firm that does X volume and nets Y. How these five critical variables interact ultimately will determine your value.

Typically, larger firms pay a lower multiple of billings than smaller firms, because they have non-partner overhead that reduces the profit percentage received. However, two other factors make the larger firm better able to pay: For one, it can pay over a longer period of time, since its size gives it longer-term credibility. Even if it pays a smaller annual percentage, it may make that up by paying for more years. Secondly, some larger firms add clients so efficiently that they do not create additional cost. For example, a firm may add high-end tax work to an existing infrastructure of expertise and software, with a niche in financial services, creating an enormous profit on the additional work. But if it adds a \$100 thousand audit, it may need to devote \$70 thousand in time to complete the work.

Internal sales differ from external sales and, accordingly, are priced differently. The seller takes less of a risk with internal sales, and therefore usually asks a lower price. The buyer, too, takes a smaller risk, and therefore will usually "lock" the price earlier. As a result, many internal sales are not based on a multiple of billings, but rather on the retiring partners' past compensation, which is often the historical net profit.

How much profit can the internal buyer make? If the successor can pay out the retiring partner and still increase his or her net, then the deal is favorable. At a minimum, the cost of replacing the retiring partner must be less than what he or she is making. In that way, younger firm partners won't have to take pay cuts to mediate the costs of senior partner buyouts.

There are no rules or simple formulas for accounting mergers. Each firm is unique and your terms will need to be molded to your particular situation and goals. There will be more questions to answer, including, "What do we review in due diligence?" "How will staff be treated?" and "When do we start and document the deal?" If there are 50 important points to consider prior to completing a merger or acquisition, the most competent and experienced of firms may know only 30.

**About the authors:** Joel Sinkin is a partner in Accounting Transition Advisors, LLC. The firm exclusively consults on merger & acquisitions in accounting. Call 866.279.8550; e-mail at [jsinkin@transitionadvisors.com](mailto:jsinkin@transitionadvisors.com) or visit [www.transitionadvisors.com](http://www.transitionadvisors.com) for further information. Max Krotman, Esq. is the executive Vice President of Globalforce International.