

Merge up, merge down, merge laterally, or just merge out?

Selling an Accounting Practice

By Joel Sinkin

What do you have to contemplate when the time comes to sell your accounting practice? Among other things, the author discusses personal considerations, transition problems, how to choose a successor (the buyer), and structuring the transfer. The seller must know at least as much about the purchaser as the purchaser knows about the seller.

By the time their clients are five to 10 years from retiring, most accountants have already reviewed and assisted in working out their financial and continuity needs, including possible future mergers or sales of the businesses. Many accounting firm owners with only five years to retirement, however, may not have yet established a successor, either within or outside the organization.

The answer, of course, is for the sole proprietor or accounting firm to give careful thought and planning to the succession of the practice. The practice may have taken many years of hard work and quality service to establish. It probably is expected to be the source of income in retirement years, either through the form of periodic payments or as a lump sum from a successor. In any event, maximizing the benefit from the practice will depend upon the successful transfer of clients to another practitioner--either future partners or a purchaser of the practice. Both the transferring firm and the successor firm will want a successful transition. Clients that are lost in the transition will usually reduce the payout to the retiring party as well as being a dampener to making future deals by the successor firm.

Ownership transitions are difficult. How to prepare for and maintain continuity, especially when egos as well as dollars are at risk, is indeed a major question.

Considerations When Selling a Practice

The single most important concern to selling or transferring a practice is the likelihood that the clients of the transferring practitioner will remain with the successor firm. Without the prospects of continuity, there can be no viable transfer. Although many variables come together in deciding when and how to sell a practice to reasonably assure

a successful transition, there are some that have greater impact than others. For purposes of the discussion, the transferor will be referred to as the seller, even though the client service may be assumed by another in a merger or by the formation of a new partnership.

Time and Client Comfort. The more frequently a practitioner usually services or communicates with its clients, the easier and more quickly a transition can take place. If a client is visited monthly, within just one calendar year, the seller and his successor should have ample opportunity to execute a proper transition. For example, during the first quarter, the seller and his successor could visit the client together. The next several visits they can alternate between the successor alone and the two together. By the last quarter, the successor should be able to go alone with the seller making an occasional follow-up by telephone.

If the seller generally sees clients on an annual basis, such as to prepare tax returns or prepare a year-end financial statement, it may take several years for clients to see the seller and successor together often enough to create a comfort level. In this type of practice, the time to put a transition plan in place is several years before the seller's actual or full retirement.

Aside from the number of visits, consideration must be given to the relationship between the seller and the clients and the level of services performed some work is so involved it may very well take additional time for an effective and lasting transition.

While some clients may be visited infrequently, the practitioner and the client may be in constant communication by telephone. After an initial personal introduction, the important thing is to get the successor involved in these communications. In the beginning, conference calls including the successor, can provide the answer. The successor should solo as soon as possible, however.

If the seller's staff has an abundance of client contact, the seller may not be needed for as long a transition. In many instances, the staff can be of greater value with certain clients than the seller. If that is the case, it will be important for the successor to continue to employ key staff that have developed the confidence of clients.

Desire or Willingness to Continue Working. This is a personal decision, affecting not only when to sell, but to whom. If a seller wants to continue working full time or even part time while a successor is put in place, he or she may have to consider successors with their own self-sustaining practices. The seller might merge with such a successor early on, in order to promote the image of greater continuity without immediately reducing workload or income. In this type of merger, a merger out (a euphemism for sale), practitioners generally phase out over a given or contractual period of time. They merge with their successor and gradually shift from full time to part time and then perhaps to consultant status. By affiliating with a successor who has a self-sustaining practice, the seller need not subsidize the successor or change his or her immediate lifestyle.

If a practitioner wants next tax season to be the last one with a full-time role, a successor should be in place by May or June of the preceding year! Most practitioners have a percentage of clients that they see only during tax season. In the "perfect world," clients should see the seller and successor working together for, at least, some period of time. By the time the seller's clients realize that he or she is phasing out, the successor will have had ample opportunity to prove his or her own competency. If the successor is in possession of the client records and the seller remains a consultant to the practice, the successor will most likely have to mess up to lose the clients.

Upcoming Investments. What if a seller is close to considering a sale or merger but anticipates the need for a significant investment that may affect the timing of the sale process? Investments might include lease renewals, computer upgrades, or a new phone system. Any of these could accelerate the desire to consider an affiliation eventually leading to a sale or just a "plain vanilla" sale. For example, if within the next year, a practitioner is considering some form of transition, why should he or she commit to an investment now? Remediating some of the needs or problems may represent nonrecoverable additional costs that may be addressed by the existing resources of a buyer.

Staffing. Can staffing affect when to sell or merge? Absolutely! The loss, by a sole practitioner considering retirement, of a manager or strong senior may be a triggering point to contemplate the sale or merger, up, down, or out. On the other hand, such an event could lead the practitioner to bring in an individual, not only to fill the current void, but to be the ultimate successor. Why should a practitioner hire, train, and work with a new employee without this potential if the plan is to start moving forward soon with some form of transition?

Choosing a Successor

The purchaser or successor to an accounting practice should make a careful review of the practice being transferred. That review should include careful scrutiny of the clients from a business and professional point of view. In effect, the purchaser must also perform client acceptance procedures on all the clients that may be a part of the practice.

The seller or transferor of the practice must also perform due diligence in order to protect him- or herself. This means the seller must take a hard and objective look at the prospective successors--the people and their practices--and determine whether they can accomplish a successful transition. The seller must, among other things, thoroughly examine the following:

Types of Services Provided. If, for example, the seller has an audit-oriented practice, then the successor firm must have been peer reviewed and possess the resources to accommodate efficient and effective audits. If the audits are of public companies or are required by lending institutions, the successor must be appropriately acceptable. If,

however, the audits are of more modest companies, e.g., small co-ops, smaller not-for-profits, etc., the size or resources of the successor firm may not be an issue of the same magnitude.

If the seller, for the most part, provides write-up and tax services primarily to small business units, the practice would reasonably require a smaller successor firm already geared up for those types of accounting services.

Size. A sole practitioner with a \$50K to \$150K write-up/tax practice may have difficulty transferring the practice to a significantly larger, say a 20-person, firm. If the seller's clients are used to having "their accountant" personally visit and spend time servicing the account monthly, it is unlikely that a larger firm partner would be available to perform those same services. More likely, a staff member would do the work, to be reviewed back in the office. Periodically, the work might be reviewed in the field, giving the partner some opportunity to "hold the client's hand" but certainly not as much as their accountant--the present sole practitioner. The billing rates of larger firm partners rarely allow them to personally visit the "card-and-gift-store owner" who pays \$300 per month.

If the practice of the selling firm is very much the work of the practitioner or partners, with very little staff involvement, the successor firm should be structured to deliver the same kind or level of service. A common failing in a transfer is to have low level, experienced staff servicing a client that was used to having the owner/practitioner do the work, something that he or she had been doing for years. The prevailing concept should be, "Find a firm that offers the greatest amount of continuity." Clients used to dealing with partners are rarely comfortable with transition to a new firm that starts out by sending lower level personnel.

Billing Rates. A successor's billing rates should be similar to avoid serious fee adjustments. Clients are fee sensitive, and most would be very reluctant to experience not only a change in personnel but also an increase in fees. Large disparities in fee structure are very difficult to make up, if at all.

Location. Does the seller have a "go to" practice--does the seller visit the clients? If so, providing the successor firm has or creates a local telephone exchange, a new office location is relatively unimportant. Should a practitioner have a "come to" practice, this frequently necessitates that the successor have, set up, or take over the seller's identity, at least for some period of time, in order to solidify the transition.

Many practices are a combination of go to and come to. This requires additional thought regarding the importance of location. For example, most individual tax clients are very location sensitive. If the practice has a significant percentage of such clients, location plays a more important role. Business clients are generally very receptive to, if not insistent on, having their accountants come to their place of business vis-à-vis going to an accountant's office. In this case, the successor's location may play a less sensitive role.

Practices that receive all their work by mail, messenger, or modem, are obviously less location sensitive. Even so, the successor firm should set up a local phone number to create a sense of being close.

Regardless of practice type, creating a sense of location continuity, at least during the transition, is important even if it calls for working out of two separate offices for a short time.

Specialties or Niche Practices. Some practices have groups of clients in the same business, e.g., they may be in construction, health care, real estate, or litigation support, to name a few. Even if the seller has only a limited number of clients in a specialty, the retention of that group mandates that the successor has the ability and necessary resources to service those clients.

Professional Credentials. Sellers should verify that successors--the purchasers of their practices--are CPA firms, peer or quality reviewed, up to date on CPE, and have no reported ethical problems. Where appropriate, documentation should be obtained.

Buyer's Client Retention Record. A successor's ability to retain clients in the past will undoubtedly affect future retention of a seller's current clients. And continuity will probably affect the contractual obligation for paying the seller, at least in part. The seller should have the opportunity to examine client work papers, client lists, and other pertinent records of any proposed successor. He or she will not only be able to get a better look at professional abilities and competence but also gain insight into specific industry skills and experience. This "examination" will also help answer the very important question: Will this purchaser have a good shot at retaining the clients and paying the seller out?

Successor's Financial Records. Many accountants help to assure that their clients keep organized and proper records, but subscribe to the adage about "the shoemakers' children" when it comes to their own records. Sellers should seek assurance that buyers maintain appropriate and perhaps even separate records to enable verification of their financial due.

Financial Review. In order to attain an additional level of comfort as to a successor's ability to meet the financial obligation of the client transfer, the seller should obtain relevant reports from sources such as TRW and Dunn & Bradstreet.

Chemistry. The most important consideration for a seller, when selecting a buyer, should be "chemistry." The vast majority of accounting clients, especially smaller ones, have little insight into the technical abilities of their accountants. Clients know their accountants, generally like them, but most of all feel comfortable with them; therefore, he or she is *their accountant*—a good accountant!

Clients will stay with the successor firm long-term if they can be made to feel the same way about the successor as they do for the seller. If sellers are comfortable on a "people-to-people basis" with their successors, hopefully their clients will be too. There are enough difficulties in retaining clients during and after a transition without personality differences and conflict being apparent between the principals. If the buyer and seller get along, it is often a good sign that the buyer and clients will, too!

Structuring the Transfer Of the Practice

What are some of the ways to structure transitions from one firm to another? The answer to this question has great impact on the success of any move. Consider the following:

Merger Contract with Buy-Out. The seller and successor merge their practices with a future buy-out, the detailed terms stipulated, signed, sealed, and delivered *up front*, creating an affiliation starting an appropriate time before the seller's retirement. Not only does this allow for a stronger, more comfortable transition of the client base, but in the event of the seller's death, permanent or temporary disability, back-up is already in place. The seller may also be the beneficiary of increased technology and support, to better service clients until the eventual buy-out.

While the buy-out can be done in stages, it is important to have it in place in advance. Neither party wants to wake up three years after initiation of the merger and realize that one or the other cannot agree on the next step of the buy-out or how to structure it. An agreement that details the entire process should be acknowledged prior to establishing any affiliation.

Sale with a Consulting Agreement. Selling a practice with a continuing consulting agreement can give the seller many features of a buy-out without the liability exposure of continuing as a partner. The greater the possibility of increased exposure to the seller, the more this arrangement may make sense. While a consulting agreement is obviously for the purpose of an orderly transition, i.e., giving the clients an opportunity to get accustomed to the change, it should not be announced to the seller's client base up front as a "done deal."

Sale<Transition<Gone. This is probably how most smaller practitioners sell their practices. The successor acquires the equity from the seller and a transition of some sort follows. The key to making this effective is the transition; there is always a need for the clients being transferred to get as comfortable as possible with the new firm.

In some client transitions, the first time many clients really understand what is happening is with the arrival of a letter announcing the new arrangement. The envelope would probably have the seller's firm name and address, ensuring that the envelope will be opened, read, and just not junked, as just another firm's marketing piece.

The letter must also stress continuity to the clients wherever possible, e.g., the person they always trusted (the seller and perhaps staff) will be part of the new organization; the fee structure will remain the same; and, the new firm will remain geographically sensitive.

Most of transfers at least start with the appearance of an affiliation, not a sale. While people, per se, cannot be bought and sold, client retention can still be amazingly effective with a proper transition. *

Joel Sinkin is a partner in Accounting Transition Advisors, LLC., a consulting firm that specializes in mergers and acquisitions of public accounting practices. He can be reached via e-mail at jsinkin@transitionadvisors.com or toll free at 1-866-279-8550.