



CPA FIRM SUCCESSION:  
SOLIDIFYING THE FUTURE

# Mergers Emerge as Dominant Trend

First in a series: New demographic and economic realities are reshaping succession strategies.

by Joel Sinkin and Terrence Putney, CPA

Powerful forces are transforming the accounting profession in the United States. The Baby Boomers are heading into their retirement years. Baby Boomer CPAs are in charge of most U.S. accounting firms. And most U.S. accounting firms don't have a signed succession or practice-continuation plan in place.

These realities are rewriting the rules for U.S. accounting firms and CPA firm owners. Gone are the halcyon days of whipping together a succession strategy, transitioning the clients to the next generation of CPAs, and riding off into a retirement funded by the new partners at the firm. Firms today must contend with unprecedented financial, cultural, and marketplace changes.

To help CPAs deal with these changes, the *JofA* is presenting a succession series designed to help accountants navigate the new landscape of succession and mergers. This installment examines the importance of understanding the mergers-and-acquisitions (M&A) market when preparing a succession plan.

### THE M&A FACTOR

M&A has emerged as a dominant trend among U.S. accounting firms. Dozens of major mergers have been announced over the past three years, and scores more have taken place under the radar. How prevalent is the merger mania? Nearly half of all U.S. accounting firms either were in merger talks or expected to be within two years, according to the *2012 PCPS Succession Survey*.

Demographics and other succession

issues are the main factors fueling the consolidation craze. The gap between the number of firms dealing with partner retirements and the number of firms with successors, or even succession plans, in place has created a need to find alternative ways to continue the practice and fund partner retirements. Increasingly,

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firms are looking to the merger markets for an exit. This trend is affecting the balance between a "buyer's market" and a "seller's market" and having an impact on firm valuations as well.

Despite all the turmoil, a firm's size and location continue to be the main factors in determining its appeal, and value, to potential buyers. For instance, small firms in densely populated areas are operating in a seller's market. A plethora of firms with the capacity to buy smaller competitors gives selling firms a number of options when seeking a suitor.

The market also favors the selling firm

because many midsize firms can absorb small firms with little to no incremental increases in overhead, especially if the selling firm isn't locked into long-term, expensive leases. That makes an acquisition a cost-effective means of growth. Buying firms, thus, are willing to pay higher prices to acquire smaller operations because it's still cheaper and easier than growing by adding one client at a time or adding a service niche to create cross-selling opportunities and attract new clients.

In contrast, small firms in remote areas remain stuck, and are likely always to be

stuck, in a buyer's market. The limited supply of potential buyers means that it's difficult for a selling firm to find a suitor. In some areas, accounting firms don't feel pressure to acquire a retiring competitor's clients because most of those clients "have no one else to go to anyway."

Where the most significant change in the buyer-seller balance has occurred is among small-to-midsize regional firms. Consider the following: In a large metro area such as Boston, there are dozens of firms generating between \$3 million and \$8 million in annual revenue and a handful of larger regional firms—those with

### EXECUTIVE SUMMARY

■ **Mergers and acquisitions (M&As) are becoming increasingly popular as an exit strategy for retiring CPA firm partners.**

New demographic and economic realities are making it more difficult for firms to complete internal succession, leaving a sale to an outside firm as the best option.

■ **Increased M&A activity**

**among accounting firms is affecting, in some areas, the balance between a "seller's market" and a "buyer's market."** The biggest change is being seen among small-to-midsize regional firms.

■ **The rising number of CPA firms up for sale is exerting downward pricing pressure on**

**firm values.** This means that time is of the essence for CPAs to figure out how they are going to pay for their retirement and whether an external sale will be necessary.

■ **Buyers are requiring longer partner-retention periods in accounting firm acquisitions** and are putting down less money upfront.

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\$20 million or more in annual revenue. The smaller firms represent good acquisition targets for the bigger firms, for the reasons already discussed, but until re-

in the near future) that they don't have the cash flow or young talent to execute an internal succession plan. The firms then have little choice but to seek an exit

## A firm's size and location continue to be the main factors in determining its appeal, and value, to potential buyers.

cently relatively few of the smaller firms have come on the market because their business has been solid and they've executed internal succession to pay for partner retirements. That pattern, however, is changing.

### DOWNWARD PRESSURE AND OTHER TRENDS

An increasing number of smaller regional firms are discovering (or will discover

via merger or acquisition. This trend is producing a larger supply of smaller regional firms, shifting the power in the marketplace to the buyers and creating downward pressure on firm valuations.

The authors have already seen values of firms drop over the past few years for both internal valuations (partners buying out partners) and external sales. Also, buying firms are putting less money down on acquisitions and are placing a

stronger emphasis on retention periods for partners with the smaller firms, which tend to have partner-loyal client bases. All of these trends will continue, with some exceptions. Firms with excellent niches, strong young talent, or a strong and growing client base can separate themselves from the competition, driving up their value.

What does this all mean for firms that have yet to complete their succession plan? When should a firm have a plan in place? Those questions will be addressed in next month's installment of this series. ❖

## The Succession Situation

Succession is a major issue not being dealt with on an adequate level within the CPA profession. Consider the following findings from the 2012 PCPS Succession Survey, a joint project of the AICPA Private Companies Practice Section (PCPS) and Succession Institute LLC:

- Nearly 80% of the CPA firm owners surveyed expected succession to become a major issue for their firms in the next 10 years.
- Fewer than half of all multi-owner accounting firms had a written and signed succession plan. The percentages dropped dramatically for smaller firms: 33% for firms with eight to 15 professionals, 25% for firms with three to seven professionals, and 14% for firms with one or two professionals.
- Only 6% of sole proprietorships had practice continuation agreements (PCAs), the first step in succession planning.

For more, see the *JofA* article "Succession Planning: The Challenge of What's Next" (Jan. 2013, page 44).

### AICPA RESOURCES

#### JofA articles

- "Succession Planning: The Challenge of What's Next," Jan. 2013, page 44
- "Planning and Paying for Partner Retirements," April 2012, page 28
- "Traps for the Unwary in CPA Firm Mergers and Acquisitions," Aug. 2011, page 36
- "Accounting Firm M&As: A Market Update," Nov. 2010, page 30
- "Mergers & Acquisitions of CPA Firms," March 2009, page 58, and "Keeping It Together: Plan the Transition to Retain Staff and Clients," April 2009, page 24 (two-part article)

Use [journalofaccountancy.com](http://journalofaccountancy.com) to find past articles. In the search box, click "Open Advanced Search" and then search by title.

#### Publication

- *Management of an Accounting Practice Handbook* (#090407)

#### CPE self-study

- Making Key Financial Decisions: Practical Tools and Techniques for Making Your Key Financial Decisions (#733835)
- Mergers, Acquisitions and Sales of Closely Held Businesses: Advanced Case Analysis (#732867)

#### Conferences

- E.D.G.E.—Sharpening the Next Generation of CPAs, Aug. 7–9, Austin, Texas
- AICPA Succession Planning Summit—Oct. 28–29 for midsize firms; Oct. 29–30 for large firms; Oct. 31 for sole practitioners and small firms; New York City and Durham, N.C.

For more information or to make a purchase or register, go to [cpa2biz.com](http://cpa2biz.com) or call the Institute at 888-777-7077.

#### Survey reports

- 2012 PCPS Succession Survey (sole proprietors), [tinyurl.com/ptyegnk](http://tinyurl.com/ptyegnk); and 2012 PCPS Succession Survey (multiowner firms), [tinyurl.com/qzhabug](http://tinyurl.com/qzhabug)

#### Private Companies Practice Section and Succession Planning Resource Center

The Private Companies Practice Section (PCPS) is a voluntary firm membership section for CPAs that provides member firms with targeted practice management tools and resources, including the Succession Planning Resource Center, as well as a strong, collective voice within the CPA profession. Visit the PCPS Firm Practice Center at [aicpa.org/PCPS](http://aicpa.org/PCPS) and the Succession Planning Resource Center at [tinyurl.com/oak3l4e](http://tinyurl.com/oak3l4e).