



Case Study Number 12: A review of alternative methods of addressing accounts receivable and work in process in mergers and acquisitions of accounting firms

In a merger

In most mergers, the members of the firm being merged in who are to receive equity in the combined successor firm, typically are asked to contribute their A/R and WIP to the successor firm to create their capital account

The A/R and WIP that is apportioned to partners of the merged in firm who will not receive equity in the successor firm (typically because they are entering into the merge for succession or their equity ownership was too small in their original firm to obtain equity in the successor firm) usually retain their A/R and WIP but more and more we are seeing them “loan” the successor firm the A/R and WIP and get a short payback period on them

In most sales

It is very rare the buyer ever acquires the seller’s A/R and WIP. In most cases the seller anticipates the first dollars coming in to be paid to them until the A/R and WIP has been satisfied. TA recommends having the successor firm handles the collection of these funds and monthly pay them back to the seller. They recommend this as they feel if each party is collection their own receivables it may send a poor message to the clients. “If we are holding a deal out as a merger, why is one firm collecting dollar one and the other dollar 2.”

That said, a difficult situation can arise as it relates to clients who are very delinquent payers. If the first dollars coming in must be paid to the seller, the buyer can be in a position on certain clients of waiting months before they are in cash flow. This may reduce their enthusiasm to fight to retain such clients. Thus TA uses the following paragraph in many of their deals as a way to make sure the successor firm can be in cash flow after a reasonable time and therefore remain motivated to service all clients.

Collection of Receivables and Work in Process

- (A) The outstanding receivables from the CLIENTS as of the TURNOVER DATE will be listed on Exhibit “B” to be provided at that time.
- (B) The work in process for the CLIENTS as of the TURNOVER DATE will be listed on Exhibit “C” to be provided at that time. This Exhibit C is to include both

work in process that has not been billed and any work which has been billed but which has not yet been completed (referred to as “Negative WIP”), if any. The FIRM will complete any work in process, invoice and divide the collections derived from such work pro rata in accordance with the time each Party devoted to each such case.

- (C) If the FIRM receives funds in payment of the amounts due from CLIENTS under the 2 preceding SUBPARAGRAPHS for receivables or work in process as of the TURNOVER DATE, such funds will be paid to the SELLER within ten (10) days of receipt. the event the SELLER directly receives such payments the SELLER shall immediately notify the FIRM of said collections and it will be deemed to have been paid by the FIRM to the SELLER.
- (D) Should any CLIENT be over thirty (30) days in arrears on current invoices from the FIRM, then fifty percent (50%) of collections from said CLIENT(s) shall be retained by the FIRM and applied against the oldest current invoices to the FIRM and the fifty percent (50%) balance shall be remitted to SELLER in reduction of the SELLER’s debt from that CLIENT, as listed in (A) or (B) of this PARAGRAPH. Such division of collections on a per CLIENT basis shall continue until the account receivable from the CLIENT to the SELLER has been paid in full.

Note that by the time a client is 30 days late to the buyer on current work, they are likely over 120 days late o the seller. For example, if a deal closed on January 1. The buyer does work in February and bills it March one the client isn’t 30 days late to April!

New Trends

In this economy, money is very tight and receivables are paying very slowly. As a result even in sales we are seeing many buyers request the seller to loan them the use of the A/R and WIP with a short, 6 to 12 month payback period.