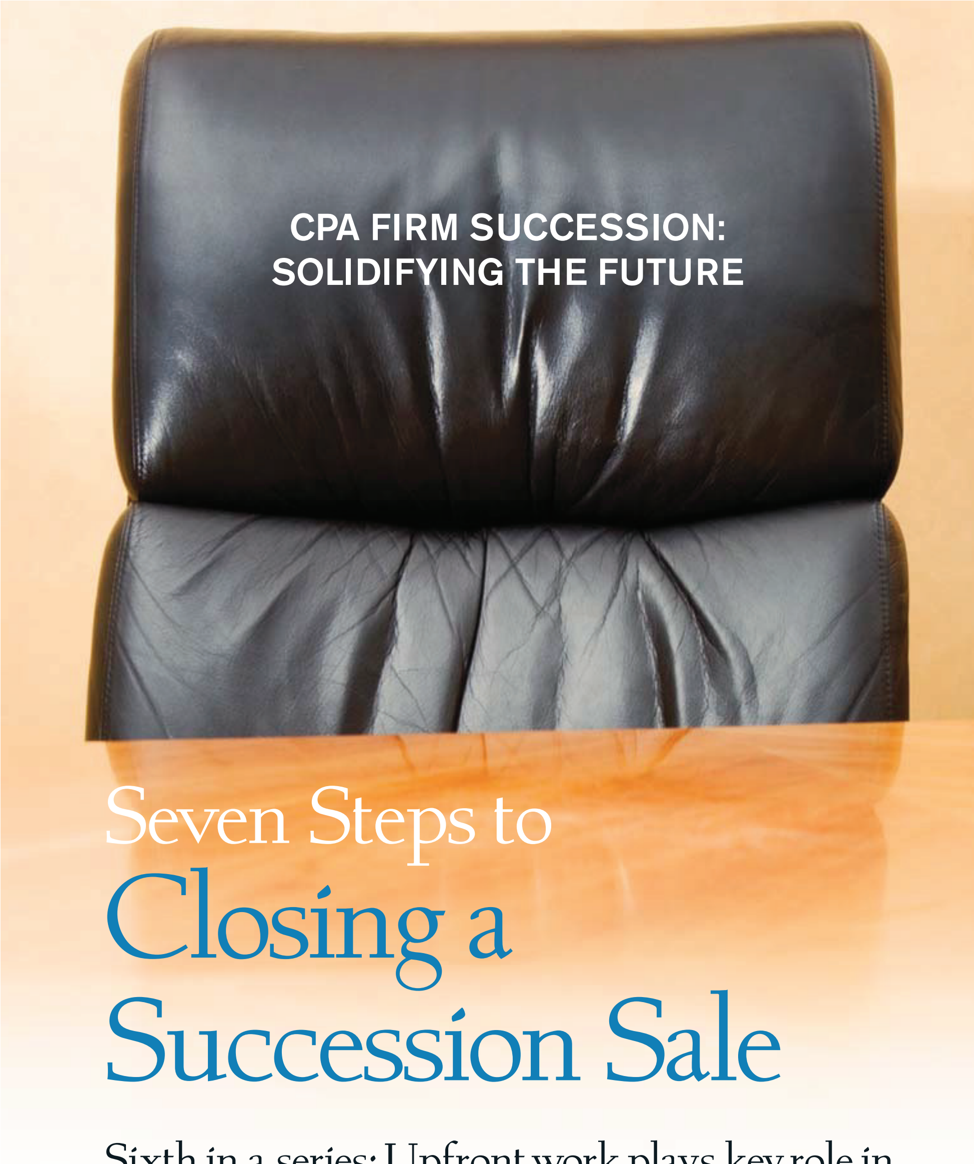

CPA FIRM SUCCESSION:
SOLIDIFYING THE FUTURE

Seven Steps to Closing a Succession Sale

Sixth in a series: Upfront work plays key role in bringing a deal to a successful conclusion.

by Joel Sinkin and Terrence Putney, CPA

About the Series

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 plan or practice-continuation agreement in place.

The *JofA* is presenting a succession series designed to help accountants navigate the new landscape of succession and mergers. This month's installment, the sixth in the series, looks at the seven steps to complete a merger or sale for succession.

Key to a successful merger or acquisition is keeping the process moving. For firm leaders, there is rarely any item of greater importance than a merger they are pursuing. The adage "time kills all deals" is absolutely true with mergers, and this is why:

- Adversarial positions: Naturally, both parties to the deal are looking for the best possible terms. For example, the seller wants to receive the highest compensation possible, and the buyer wants to pay the least. Successful deals depend on the parties working together for a common positive outcome. However, the longer negotiations last, the more likely the talks will develop an adversarial tone.
- When a successor firm is slow to move the process along, many firms seeking an acquisition wonder two things:
  - If this is not a priority for the successor, am I talking to the right firm?
  - Does the successor firm have the capacity to take on this venture?

  (Neither of these perspectives, which are inevitable with delays, leads to a good outcome.)
- Every time someone reads a contract, it has new meaning, and, all of a sudden, issues that were previously resolved become new problems. That leads to more delays and more conflict.
- Some things can't be kept under wraps forever. Many times word gets out that a firm is "in play." This can lead to competitors and constituents acting on incomplete and false information.

The Seven Steps

Following are seven steps for deal management designed to keep the process moving. This is not to suggest that one should rush to get a deal done, throwing caution to the wind. Rather, the parties need to focus and commit to the process until they realize they have a viable deal or they don't. This improves the probability of closing a deal that should be done and avoids wasting time and resources on one that wasn't meant to be.

Step one. The firm seeking to merge up or sell should prepare a generic practice

PHOTO BY ISTOCK/THINKSTOCK

information sheet. Generic, in this case, means that the document should not disclose client names and other confidential information. The sheet should include strategic goals for the affiliation and the operating characteristics of the selling firm, including fee volume, services rendered, types of clients, billing rates, headcount for staff and owners, profit margin, and other information necessary for a potential purchaser to determine initial interest.

Strategic goals should include near-term transition plans for partners, if applicable, and possibly growth, expansion, and other upside opportunities that can be accomplished through a merger. For example, a four-partner firm might have one partner seeking immediate succession, another who is looking to slow down in five years, and two younger partners who are seeking long-term growth but lack the capacity to replace the partners with near-term transition plans. The objective of this summary information is to share what the selling firm has and what it believes a successful merger would look like. This allows the other firm to determine whether there is a foundation to move forward.

Successful deals depend on parties working together for a common positive outcome. Longer negotiations are more likely to become adversarial.

Step two. The parties should identify "must-haves" and be ready to discuss them. Often there are certain items that would be deal breakers if they are not handled in a way that meets the selling firm's needs. The authors recommend those items be discussed upfront with the other party so they don't come up late in the process, after extensive negotiations, to kill the deal. Examples of must-haves include unexpired leases, location requirements, status of merging partners, compensation, other deal terms, staff retention, and other operating requirements.

This requires keeping in mind three things:

1. The more must-haves a firm presents, the fewer firms are likely to be interested in a deal. Some of these must-haves can affect a firm's value.
2. There are sometimes ways that haven't been thought of yet to overcome an issue considered a must-have, but the firm must be open to finding alternative win-win outcomes.
3. The firm needs to categorize "must-haves" into (a) what it really must have, (b) what it strongly prefers, and (c) what it would like to have.

The name of the successor firm is sometimes listed as a "must-have" for firms seeking an upstream merger or sale. There may be valid reasons for that to be on the list, but the authors have found very few instances where changing a firm's name because of a merger has had any discernible impact on the deal's success. Keeping a name does not replace the need for a comprehensive transition plan whereas a proper transition and communication strategy almost always overcomes any issues associated with a name change.

Must-haves that are easy to explain (such as unexpired leases) are best included in the summary information, while more complicated ones are best discussed in the initial meeting.

Step three. The firm should define what its merger partner/successor should look like. This involves using the four C's, as described in detail in the third article of this series, "How to Select a Successor," *JofA*, Sept. 2013, page 40. Here is a brief recap of the four C's:

- *Chemistry:* If you don't want to eat

EXECUTIVE SUMMARY

- **Among the biggest threats to accounting firm merger deals are delays.** It's imperative to keep the process moving because the passage of time increases the likelihood of events occurring that could scuttle the deal, including an adversarial tone developing, late changes to contracts provoking a dispute, questions being raised about the importance of the deal to the other party, and word leaking of the deal discussions.
- **Firms seeking to sell or merge into another firm should prepare a generic practice information sheet.** The sheet should cover strategic goals for the merger as well as information about the firm's fee volume, services, types of clients, billing rates, headcount, and profit margin, among other items. The sheet should not include confidential information.
- **Selling firms also should identify "must-haves" upfront** and have a profile in mind for the ideal successor to any partners who will be cashing out. These items should be covered in initial merger meetings.
- **Firms should discuss deal terms early in the merger talks before extensive due diligence takes place.** Firms often complete due diligence first and then discover deal breakers when terms are discussed. Firms that create a foundation for a deal upfront can still pull out if something material is discovered in due diligence.
- **The last of the seven steps in an accounting firm merger is closing the deal.** This is the time to bring in the lawyers.

Joel Sinkin *(jsinkin@transitionadvisors.com) is president, and* ***Terrence Putney*** *(tputney@transitionadvisors.com) is CEO, both of Transition Advisors LLC in New York City.*

To comment on this article or to suggest an idea for another article, contact Jeff Drew, senior editor, at jdrew@aicpa.org or 919-402-4056.

lunch with someone regularly, don't merge with that person. In other words, if the partners don't personally like the people they are talking to, why would their staff and clients like them?

- *Capacity:* Understanding the goals for a deal leads to knowing the capacity issues required of the other firm. For example, if one partner is slowing down soon, the successor firm must have the capacity and skill set to replace that partner.
- *Continuity:* Most accounting firms have their client base because their clients are *comfortable* with their people and approach to service. Clients tend to focus on fees, how services are provided, the level of hand-holding, and specialties, to name a few. A successor firm must be able to avoid the clients' viewing the merger as a loss of a prior firm and instead promote the gain of the combined firm.
- *Culture:* This term is used a lot but remains a vague concept for many. Culture can be thought of in three ways: (1) What's it like to work here?; (2) What's it like to be a client here?; and (3) What's it like to be a partner here? A selling firm needs to consider if a merger candidate or buyer can cut the mustard in all three areas.

Step four. Before any meetings occur, information and goals should be shared with, and preliminary information obtained from, the other firm. This qualifies both firms for each other. Now attention can be turned to the four C's and the must-haves in initial meetings. The firms should share what they believe success looks like and find out what their strategic goals are for the merger. What do they intend to accomplish? What is their business plan for this merger?

Step five. The potential deal terms should be addressed as soon as possible. If several firms are courting the selling firm, the field should be narrowed to ones the selling firm likes and those that like the selling firm. The selling firm should obtain a nonbinding offer from the firm(s) it likes of how the firms would come together. It is not unusual for this to happen as early as after one initial meeting and certainly after no more than two.

Many firms think they need to perform due diligence before making an offer. However, it should be kept in mind that every step described above is part of due diligence. In step one, the selling firm has already told the other firm what it has and what it wants. Other critical issues can be addressed in the form of additional inquiries. It is appropriate to assume the information and responses are accurate. The nonbinding offer should describe

The firms should share what they believe success looks like and find out what their strategic goals are for the merger.

AICPA RESOURCES

JofA articles

CPA Firm Succession series

- Part 5: "How to Value a CPA Firm for Sale," Nov. 2013, page 30
- Part 4: "A Two-Stage Solution to Succession Procrastination," Oct. 2013, page 40
- Part 3: "How to Select a Successor," Sept. 2013, page 40
- Part 2: "The Long Goodbye," Aug. 2013, page 36
- Part 1: "Mergers Emerge as Dominant Trend," July 2013, page 52

Other *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
- "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** 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, loose-leaf; and #MAP-XX, one-year online subscription)

CPE self-study

- Advanced Mergers, Acquisitions, and Sales: Complex Case Study Analyses for Closely-Held Businesses (#732868)
- Making Key Financial Decisions: Practical Tools and Techniques for Making Your Key Financial Decisions (#733835)

Conferences

- Practitioners Symposium and TECH+ Conference, June 9–11, Las Vegas
- For more information or to make a purchase or register, go to **cpa2biz.com** or call the Institute at 888-777-7077.

Survey reports

- *2012 PCPS Succession Survey* (sole proprietors), **tinyurl.com/ptyegnk**; and *2012 PCPS Succession Survey* (multiowner firms), **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** and the Succession Planning Resource Center at **tinyurl.com/oak3l4e**.

what a deal would look like philosophically and financially, subject to verification in due diligence.

Too many times the authors have seen firms go through extensive field due diligence that confirmed all the information shared originally was 100% accurate, only to make an offer that was not acceptable. This is an inglorious waste of time. Creating a foundation for an agreement with which both firms are comfortable justifies field due diligence. In the unlikely event a surprise emerges in due diligence, the offer can be adjusted or withdrawn since it was nonbinding to begin with.

The terms should be complete as to must-haves, deal structure, and terms.

Step six. Now is the time to perform field due diligence. Each firm should share what information and data it is seeking from the other, and appropriate nondisclosure agreements should be signed (if not done previously).

The authors suggest breaking due diligence into three parts to keep the process moving. First, information that is easily available should be shared. Frequently, this can be done through email. Second, the parties should exchange information that needs more effort but that is still only data. Third, the parties should conduct field due diligence in each other's offices. This is not to imply all three steps can't be done at once. What's important is to not let the process stall, waiting for the last piece of information to become available.

In a subsequent installment of this series, the authors will share in great detail suggested items that should be covered in due diligence. PCPS members can also obtain guidance in Chapter 10 of the Succession Planning Resource Center available at tinyurl.com/cx2nauz (PCPS member login required). This material includes detailed guidance on due diligence and also on the entire M&A process.

Step seven. Now that it is time to close the deal, the parties can bring in lawyers. The selling firm's partners probably have enough experience to negotiate financial terms and business plan issues on their own, or they might be using a consultant to assist. Often the best use of legal advice is to make sure the deal that is negotiated is properly memorialized in a contract and the legal i's are dotted and t's crossed.

It is best to avoid renegotiating deal terms on which agreements have already been reached, and contract drafts should not be used as a tool for further negotiations of financial terms and business plan issues. If something new, other than a legal issue, needs to be addressed, it should be brought up orally. Few things irritate the other side more than a new item suddenly popping up in a contract draft. ❖