Journal of Accountancy®

A Publication of the American Institute of CPAs
July 2016

For sale

Selling a CPA practice can include major hazards. Learn how to avoid them.
22

PLUS

Nurturing the human element of audit quality
28

Creativity sparks not-for-profit fundraising
34

Tech panel discusses CPA priorities
42

PRACTICE MANAGEMENT

Navigating the path to success in accounting practice sales

Knowing how to avoid major hazards when seeking a buyer can make all the difference between a profitable conclusion and a disastrous outcome.

PHOTO BY GUALTIERO BOFFI/ISTOCK

By Harry L. Olson, CPA

Copyright 2016. American Institute of CPAs, Inc. All rights reserved. Reprinted with permission from the Journal of Accountancy.

Risk is inherent in any business activity, including the sale of a CPA practice. From the seller's perspective, minimizing risk in the process of marketing and negotiating a CPA practice sale should be considered as important as maximizing the sales price and terms—a subject analyzed in detail in the November 2015 *JofA* article "Maximize Proceeds in Accounting Firm Sales" (page 34).

Failure to avoid the following hazards in your efforts to sell a CPA practice can be catastrophic to both your firm and your financial future. Scenarios similar to the following fictional narrative are far too common.

Imagine that you are nearing retirement and preparing to sell an accounting practice that exacted 35 years of "blood, sweat, and tears" and is a highly successful and profitable operation.

You meet with a potential purchaser who has expressed interest in the firm. Without meeting any other potential buyers, you conclude that this buyer is a "perfect" fit for your practice. You tell this CPA your price and terms. He appears to have no objections except to say that he cannot make his offer until after his due diligence is concluded.

On a beautiful day in June, the two of you shake hands to acknowledge that you will work toward a mutually beneficial deal. Without concrete knowledge of the price and terms this "perfect" buyer might be willing to offer, you provide him with a client list and a massive amount of financial data related to your accounting firm. You also arrange meetings between the buyer and your key employees as well as your largest clients. The buyer "drags his feet" for months in finalizing his due diligence while you await his offer. You assume he is operating in good faith.

After six months of delays, he finally submits an offer in early December. You are shocked to learn your "perfect" buyer has just made a lowball offer on both the price and the down payment. To make matters worse, the majority of the purchase price is contingent on client collections to be paid on an earnout basis—a structure you would never accept. By intentionally waiting until December to make his lowball offer, this buyer intends to benefit from your lack of options and time to obtain another deal before the coming busy season. Your respect for this buyer has been destroyed by his disingenuous negotiating ploy. You tell this buyer to "take a hike" as you reluctantly prepare for another busy season without a sale.

Days later, you are panic-stricken when you hear that this "perfect" buyer just offered a job to one of your key employees. He has also contacted several of your largest clients to ask them if they knew that you are retiring, while suggesting his services as an alternative. The potential buyer has also mentioned to several other CPAs that you will be "retiring," and this news has filtered into the general marketplace. You become painfully aware that you never executed a written nondisclosure agreement with this once-potential buyer.

Anxiety pervades your thoughts, causing many sleepless nights as you envision the ramifications of your 35-year-old CPA practice potentially vaporizing into thin air.

Fortunately, a seller can put countermeasures in place to avert such a devastating and unmitigated disaster when pursuing the sale of an accounting practice. This article explores some proven strategies and procedures used to circumvent each of these potential hazards in the marketing and negotiating process. While this article focuses on the sale of accounting firms, the advice applies to the sale of many other types of businesses and can help produce positive results in myriad industries and situations.

PROTECTING THE SELLER'S CONFIDENTIALITY

CPAs tend to be trustworthy. Breaches of confidentiality rarely occur when the seller requires a signed nondisclosure agreement from the buyer at the start of the process. However, even ethical people can rationalize questionable conduct that might be harmful to a seller when no agreement binds the parties.

Knowing this, the seller of a CPA practice should *never* conduct a substantive conversation with a prospective buyer or provide detailed information regarding the sale until the parties have executed a nondisclosure agreement. Failure to heed this advice leaves the seller irreversibly exposed to the possibility of abuse with negligible recourse.

The agreement should be prepared by an attorney and should include, but not be limited to, the following confidentiality provisions:

- The buyer shall not disclose the existence or conditions of discussions between the buyer and the seller.
- The buyer is allowed only limited use of the seller's information.
- The buyer will conduct no discussions with employees or clients without the seller's authorization.
- The buyer is not allowed to hire employees or solicit clients of the seller's firm without the seller's authorization.

A good attorney should set you on the right path for an agreement that minimizes the risks pertaining to your clients, employees, and confidentiality ▸

while also providing for prompt and adequate redress in the unlikely event that a potential purchaser violates any of the agreement's terms.

THE STRONGEST CONFIDENTIALITY PROCEDURES

Despite the best efforts of many sellers, one potential threat to a seller's confidentiality cannot always be averted by asking a buyer to sign a nondisclosure agreement. Consider the following fictional example that parallels actual events:

Imagine that you contact a CPA to disclose your intent to sell your firm. The CPA indicates that she is not interested and does not sign your nondisclosure agreement. Weeks later, you begin receiving calls from various leaders in your community asking whether it is true that you are selling your firm—including a call from a major client. You find that this CPA is an acquaintance of your client. You determine that she has compromised your confidentiality in the community and is attempting to obtain your major client as her own. Regrettably, the seller is unlikely to have any recourse in this situation.

Fortunately, a proven method exists that provides legal recourse to the seller before the seller's identity is disclosed to a single buyer. This strategy also provides layers of confidentiality protection that could never be implemented by the seller alone.

If you hire a business broker or experienced professional consultant to help with the sale, make sure he or she is following best practice confidentiality procedures. For instance, a business broker or consultant should never provide a seller's name or financial information to a potential purchaser without first obtaining a signed nondisclosure agreement. If the broker or consultant's agreement is properly crafted, it will protect the seller as a third-party beneficiary while not identifying the seller. Once a potential buyer signs this agreement, the broker or consultant should provide the seller's information in redacted form—absent any identifying information. Next, the broker or consultant should conduct a substantial interview with the buyer to identify the buyer's interest level and whether that buyer fulfills all of the seller's qualifications and criteria.

The broker or consultant should screen a large number of potential purchasers. Only fully qualified buyers should make the short list to be recommended to the seller. For further protection, the seller should approve each buyer on the short list before the seller's identity is disclosed—and before scheduling any face-to-face meetings. Any purchasers not approved by the seller should not receive the seller's name.

It should be obvious that confidentiality is significantly strengthened when a business broker or consultant operates in this manner. Unfortunately, not all brokers and consultants use these procedures. Sellers should realize that confidentiality procedures any less comprehensive than those described above could produce a detrimental outcome.

AVOID DUE DILIGENCE PRIOR TO ACCEPTING AN OFFER

Allowing a potential purchaser to perform due diligence before an offer is made and accepted puts the cart before the horse. Without an acceptable offer beforehand, due diligence may be a complete waste of time for both parties.

You may wonder how a purchaser can make an offer before performing due diligence. It is done all the time. Here is how:

The first step after the purchaser has signed a nondisclosure agreement is to provide the purchaser with comprehensive financial information in

IN BRIEF

- CPAs seeking to sell an accounting practice should avoid revealing too much information upfront to potential buyers, who could leverage that information to poach clients and employees without buying the firm.
- CPA firms seeking a buyer should take measures to protect their identity until a nondisclosure agreement is reached with any and all interested parties. Premature revelation of the intention to sell and/or retire could lead to competitors using that information to lure away clients.
- A business broker or consultant can provide a helpful layer of separation between sellers and potential buyers in accounting firm transactions. Sellers should make sure brokers/consultants follow best practices in protecting their identity and assets during the sales process. Also, sellers should push for as many potential buyers as feasible to create competition for the firm.
- CPA firms should avoid prematurely announcing a sale to employees or clients. If the deal falls through, the potential exists for embarrassing follow-up communications with employees and clients.

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.

redacted form. The information provided at this early stage is extensive and beyond the scope of this article. The objective of providing such comprehensive information is to leave few questions in the buyer's mind about your firm, including the type of work you perform, profitability, employees, and other significant information a purchaser would typically need to know.

The primary goal of this approach is for due diligence to be performed only once—by the purchaser whose offer is accepted and whose deal closes. If the information provided is complete, the purchaser will have a well-rounded understanding of all material aspects of the seller's CPA practice before making an offer. Comprehensive information provided early in the process also reduces each buyer's psychological and analytical insecurities regarding the merits of the transaction under consideration—with more buyers potentially willing to make offers for the practice. The seller further benefits from the direct correlation that exists between minimizing buyer insecurities and maximizing the selling price.

The purchaser's offer should be made in the form of a letter of intent (LOI). An LOI for the purchase of an accounting firm is typically nonbinding. Despite its nonbinding nature, an LOI is extremely useful in knowing whether a purchaser and seller have reached an agreement on the selling price and other material terms before entering into due diligence.

A letter of intent may contain three or more contingencies, including the following:

- Satisfactory completion of due diligence.
- Financing approval and funding (if applicable).
- Final definitive purchase-and-sale agreement (P&S) signed by both parties.

To avoid unnecessary delays, a seller should require short deadlines for completing due diligence, securing financing, drafting the P&S, and closing the deal.

A seller should rarely enter into due diligence before an LOI is issued and accepted regardless of whether a seller believes such a buyer is a "perfect" fit for the seller's practice. When a buyer is unyielding and averse to making a written offer prior to conducting due diligence, the seller should consider pursuing another potential buyer.

AVOID PREMATURE ANNOUNCEMENTS TO EMPLOYEES AND CLIENTS

When a seller and a potential purchaser sign an LOI, the intent of the parties is to work toward a closed deal. However, it is entirely possible that a major contingency of the LOI may never be satisfied—resulting in the deal never closing.

A CPA practice seller should never conduct a substantive conversation with a prospective buyer until the parties have signed a nondisclosure agreement.

Imagine how embarrassing and unprofessional it would be if you were the unfortunate seller who must explain to the firm's employees and clients why the CPA you introduced as your successor is somehow no longer your successor. This displays bad judgment to your employees and clients and costs you significant credibility. You have also prematurely signaled your intent to retire, with no successor in place. This creates uncertainty in the minds of clients and employees that can be detrimental to the practice's future profitability, marketability, and value.

So when is the right time to tell the employees and clients?

Employees

A seller should not mention to the employees that the firm is for sale or that a successor has been found until all of the following have occurred:

- Both parties have signed an LOI.
- The lender has approved the financing (if applicable) in writing, the deal's closing and funding are pending, and the lender has scheduled a closing date.
- The parties have agreed to the P&S and all other documents.
- All aspects of buyer and seller due diligence have been completed with the exception of the buyer interview with key employees and the key employees signing an employment agreement with the buyer's firm.

Most purchasers wish to retain key employees. When the announcement is made to the employees, you and the buyer should explain the buyer's intent with respect to hiring the employees and making minimal changes to their jobs early in the transition.

The key is to avoid making an announcement before you are reasonably certain that the deal will close. This approach proactively minimizes employee insecurity.

Clients

The seller of a CPA practice should not notify clients of a potential sale until after the sale is

fully closed and funded. The purchaser should not meet with any of the firm's clients until then.

Deals can die before closing for many reasons. One worth mentioning involves an employee who might kill the deal because he or she is unwilling to sign the buyer's employment agreement.

Most sellers would be glad they waited to make an announcement to their clients in case an obstacle arises that keeps the deal from closing.

COMPETITION IS ESSENTIAL FOR KEEPING THE DEAL ON TRACK

The existence of competition among potential purchasers is absolutely essential for a seller to achieve and maintain leverage throughout the process until closing. A seller should meet with several qualified buyers and receive a few offers before accepting one.

Dealing with multiple qualified buyers early on provides the following benefits to a seller:

- The seller has the opportunity to evaluate multiple options when choosing a buyer who is a better fit for his or her practice.
- Competition gives the seller the leverage needed to receive the full market value for the practice.
- Having more than one offer gives the seller a fallback position if a buyer is dragging his or her feet in complying with the deadlines of an issued and accepted LOI or if a buyer is attempting to adversely change the LOI's agreed-upon terms.

Optimally, a seller should confidentially connect with a group of buyers large enough to be distilled into an adequate short list of qualified buyers meeting all criteria, including the potential willingness to commit to the seller's asking price and terms.

If the buyer subjects the seller to unreasonable delays, fails to comply with the deadlines in the LOI, or inappropriately attempts to change the terms of the LOI, it is perilous for the seller to have no other options. The seller must maintain leverage throughout negotiations.

CONCLUSION

I have spoken with many CPAs who have unfortunately suffered the adverse consequences of being unprepared for one or more of the hazards described in this article. The story always begins with a phrase such as "he seemed like such a great guy" or "our two firms seemed to have such synergy." Regrettably, little can be done after the fact.

Most of these sellers find that they have no legal recourse if the prospective buyer did not sign a nondisclosure agreement. Some have found themselves with the professional embarrassment of a premature announcement made to clients or employees. Others patiently waited through months of buyer delays—only to receive an unacceptable offer just before busy season.

Most CPAs who are cognizant of these hazards would agree that these problems should be avoided. When the proper measures are implemented early in the process, a seller will be armed with procedural and legal remedies that can aid in preventing an otherwise disastrous situation. ■

About the author

Harry L. Olson is president of Accounting Broker Acquisition Group Inc. (accountingbroker.com).

The following extremel important information is highly relevant to an seller who wishes to obtain maximum value for their accounting practice sale and was not part of the original JOA article.

Receive the Free Report: "12 Fatal Errors You Must Avoid When You Sell Your CPA Firm"
Click Now: https://accountingbroker.com/freereport/

Learn more expert M&A tips in published articles written by the founder of Accounting Broker Acquisition Group to help sellers achieve maximum value:
Click Now: https://accountingbroker.com/articles/

Call or email now for free consultation to see what Maximum Value could mean to the sale of your practice:
(800) 419-1223 Ext. 101
maximizevalue@accountingbroker.com