Selling Your Accounting Practice?

Avoid the Costly Mistake of Choosing the Wrong Buyer

By Harry L. Olson, CPA

The largest transfer of firm ownership in the history of the accounting profession is now underway. Owners of CPA practices are retiring in record numbers. Regrettably, many of these Baby Boomers have no internal succession plan in place.

Often, the best alternative to an internal succession plan is finding a buyer for the practice. Choosing the wrong buyer can be extremely costly – both in terms of client loss and lower firm value. However, some CPAs have misconceptions about the type of buyer to choose. Others have no idea what to look for in a buyer.

The following buyer selection criteria is helpful to consider when selling your accounting practice to an outside buyer. Failure to heed the following selection criteria can result in professional embarrassment and significant financial loss to the seller. Alternatively, a seller who is mindful of these issues will be better prepared to minimize client attrition and maximize the transformation of accounting practice value into dollars ultimately appearing in the seller's bank account.

Desired Deal Structure and Due Diligence

Sellers often do not achieve the purchase price and terms they desired because the wrong buyers were at the table from the beginning of the process. It is common for a seller to call a couple of respected local competitors to see if they would like to purchase the firm. Assuming these competitors respond favorably to the inquiry, the seller often has no idea what some buyers are willing to pay until near the end of the process … after the buyer's due diligence is complete.

Allowing the buyer to perform due diligence prior to an offer is completely backwards and subjects the seller to potential problems. Many buyers who utilize this approach impose significant delays in making an offer over many months until just before the seller's busy season. Too late, the seller finds that the buyer is willing to offer nothing more than a low priced deal with a zero-cash-down "earnout" that is 100 percent contingent on collections from the clients of the firm being sold. Due to the timing of the buyer making the offer late in the year, such a seller often has two choices – accept the atrocious deal that has been offered or go through another busy season and attempt to sell the firm again next year.

When it comes to ensuring a favorable deal structure, a better process to determine which buyers should be at the table from a negotiating standpoint is as follows. First, multiple buyers should be identified – not just one or two. Multiple buyers provide a seller with crucial negotiating leverage throughout the process. This is one significant advantage of inserting a CPA practice broker into the process. In fact, most sellers do not have sufficient time to manage the CPA practice while concurrently performing an adequate and confidential promotion of the firm to find enough buyers to enable negotiating leverage.

Next, each buyer should be provided comprehensive disclosure related to the firm only after first signing a confidentiality agreement. If the information provided to potential buyers is comprehensive enough, each buyer will have adequate information to determine what they will be willing to pay for the practice, as well as the terms they are willing to offer.

The seller should conduct meetings only with the best candidates. Any candidate who verbally indicates that the deal would likely include a low cash payment and large contingency should be eliminated immediately. All buyers who are unwilling to issue a letter of intent prior to performing due diligence should also be removed from the process. The letter of intent should state the buyer's price and terms with three contingencies: due diligence, financing and the final definitive agreement.

Assuming that letters of intent are received from more than one qualified buyer willing to pay the seller's price and meet the seller's terms, the seller will be in the ultimate position of negotiating a superior deal for the sale of the firm.

Professional Qualifications

Selling a practice to a buyer who is not professionally qualified is a recipe for disaster. Optimally, the buyer of a CPA practice should have significant experience in the type of work the seller performs. The purchaser should possess the professional gravitas to elicit the immediate respect of the clients and to rise to the challenge of all technical aspects of the CPA firm being sold. This is true whether the buyer is a firm or an individual CPA.

If a buyer has significant professional qualifications, but lacks direct experience in certain highly specialized areas of the seller's practice, then a longer transition with the seller may be necessary. This allows time for the buyer to gain the specialized knowledge to retain the clients of the seller's practice, while providing the same high level of service.

People Skills

Most owners of successful CPA firms believe that the people side of the business is just as important as the technical side. Most accountants probably know at least one CPA who is an exceptional technician, but unfortunately has less than desirable people skills. Selling to a person who does not have good people skills can negatively affect employee and client retention. Fortunately, technical skills and people skills are not mutually exclusive.

When evaluating potential purchasers, a seller should consider whether each buyer has the people skills to elicit feelings of confidence and trust from the clients and employees. The ultimate buyer should make the clients and employees feel at ease and mesh well with the existing culture of the firm.

Excess Capacity to Perform the Client Work Required

It is quite common for a seller who is retiring to work part time for the buyer when so desired, while being paid by the buyer for billable work performed. Although such an arrangement is not required in many transitions, it can often help the transition process go smoothly.

It should be noted that selling a CPA practice should seldom include the seller performing billable work after the sale without compensation. In addition, the seller of an accounting firm should rarely consider a deal that would require the seller to perform the same level of work as before the sale – even when the seller is to be paid for billable work by the buyer. This type of deal almost always results in the seller making less money working for the buyer than the seller would have on his/her own.

The profit incentive necessary to make most deals work from the buyer's perspective is intertwined with the notion that the purchaser will be able to eliminate all or most of the compensation previously paid to the seller, coupled with the elimination of redundant overhead. In many situations, the buyer can reduce the redundant overhead between the two firms. Despite this fact, the redundant overhead elimination is rarely large enough for the buyer to profit from the transaction while paying the seller 100 percent of the compensation the seller was paid prior to the sale.

When elimination of excess seller compensation is a major goal of the buyer, it is clear that the buyer should have the inherent excess capacity to perform all or most of the work that the seller previously personally performed. The buyer's capacity should be analyzed in conjunction with the capacity that will be provided by the employees of the selling firm who will be employed by the buyer. Consideration must be given to the fact that most owners of CPA firms perform significant billable work that his/her current employees are not capable of performing on their own.

Occasionally, some deals falter because the buyer and/or seller overestimated the capacity of the buyer to complete the workload demanded by the seller's former clients. However, carefully selecting a buyer with adequate excess capacity will provide greater assurance that the sale and transition will be profitable for both the buyer and seller.

Financial Qualifications

One absolute truth in the M&A business that some sellers learn the hard way is as follows: The seller cannot receive significant cash at closing from a seemingly willing buyer if that buyer does not have the actual ability to pay significant cash at closing.

A seller should not tie up too much time with someone who says that he/she is willing to pay the seller's price and terms, but has not proven the ability to do so. Such buyers often irrationally hope for a miracle during the lending process. Others disingenuously intend to convince the seller to accept a lower percentage of cash later in the process.

The buyer should prove the ability to pay significant cash at closing early in the process prior to the seller accepting that buyer's letter of intent. Alternatively, the buyer should have the financial qualifications to obtain a bank loan for the purchase of the practice. Indicators of adequate financial qualifications for a bank loan would include possessing the bank-required down payment, sufficient working capital and qualifying credit score.

Despite a buyer's verbal and even written affirmations of willingness to pay the seller's price and terms, a buyer who is undercapitalized, or does not provide the seller proof of the wherewithal to obtain a bank loan, should be avoided.

All Criteria Crucial

Whether the buyer is a great fit for the seller's CPA practice will have a significant impact on client retention. As a result, the most important aspect of choosing any buyer is whether that buyer is adequately qualified to perform all technical aspects of the client work while using people skills that will build the interpersonal relationships of the seller's firm.

Regardless of such qualifications, sellers who have chosen a buyer who has little to no skin in the game often find such a buyer to lack the necessary "incentive to perform" when the going gets tough – resulting in the buyer potentially "cherry picking" the top clients while dismissing the remainder of the client list.

The key to choosing the right buyer should include determining whether that buyer meets all criteria identified above, in addition to any other criteria important to the specific practice being sold. A buyer who "fires on all cylinders" is more likely to be identified when a seller has many buyers to choose from early in the process. When the ideal buyer and deal structure has been identified and negotiated, client retention and profit derived from the sale can be maximized for the seller. ■

Harry L. Olson, CPA is the president of Accounting Broker Acquisition Group – a national merger and acquisition consulting firm specializing exclusively in the promotion and sale of CPA practices. Accounting Broker is the only national business brokerage of its type comprised 100 percent of brokers who are CPAs possessing significant "Big Four" M&A experience. He may be reached at the following website: https://accountingbroker.com.

Please see next page for important additional information.

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