Operating an accountancy practice in today’s highly regulated environment is not an easy task. Clients, staff and cashflow all contribute to many accountants questioning their choice of profession. In their darkest days many practising accountants have considered the possibility of selling their practice. Conversely it is a natural progression for accountancy practices to expand. The growth of an accountancy practice can be achieved in many different ways, but purchasing a block of clients or an existing practice is probably the most direct route for rapid expansion. For this reason, from time to time, practising accountants who, at one stage may have thought about selling their practice, may have also considered the possibility of purchasing a practice. Both avenues are fraught with potential pitfalls and hazards and neither decision should be taken lightly.

As with all trades the rules of supply and demand prevail, with the seller and purchaser having very different agendas and desired outcomes. The seller wants to maximise the sale price for his client base, while the purchaser seeks the lowest possible price to acquire the goodwill. Currently the market for buying and selling practices favours the seller with demand exceeding supply. This can be clearly seen from the interest generated when a practice is put on the market. While there can be no definitive guidance for purchasing or selling a practice, both parties involved must look at the transaction from both the seller’s and purchaser’s perspective in order to reach agreement.

**Goodwill**

The purchase of an accountancy practice is effectively the purchase of goodwill. This goodwill exists on the basis that there is a continuing business, which will generate future profits. Legally defined goodwill is “Nothing more than the probability that the old customers will revert to the old place even though the old trader has gone” (Lord Eldon in Crutwell v Lye). The sale price of a practice on an open market will invariably be calculated on a multiple of annual fees, but it is essential when agreeing this multiple not to lose sight of the fact that goodwill is the asset being traded. The valuation of goodwill should ideally be based on the profits that the block of clients will generate rather than the additional income they will produce. The aim of the purchaser should be to create profit rather than to merely acquire supplementary turnover.

**Synergies**

Acquiring an accountancy practice with a view to incorporating it into an existing practice has the potential to produce many synergies. Seasoned campaigners, who have gone through the process of purchasing a practice on more than one occasion, have identified the achievable synergies as a significant consideration in the overall deal. The scope for increased productivity and reduced overheads can have a significant effect on the multiples used and the eventual valuation of the purchase price. The review of the potential synergies should include reviewing the increased expertise and specialism, reduction in staff numbers, reduction in office space, economic usage of equipment and software, reduction in general overheads and an improved quality of service.

**Clients**

Clients are the fundamental consideration when buying an accountancy practice. Goodwill and future
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Profits are dependent on these clients. The profiling of the client base being acquired is imperative for the success of the purchase and certain information should be obtained in relation to all clients in the portfolio at the initial stages of the purchase. The data, which should be collated, includes:-

- Activity and industry sector
- Entity type – limited company / sole trader / partnership
- Decision maker’s age
- Turnover
- Type of recurring work and annual fee
- Type of special assignments undertaken recently
- Fee recovery history
- Length of relationship with the practice
- Relationship with principals or staff
- Dependency of relationship with staff
- Relationship with other clients
- Geographic location of client

The clients should be grouped based on recurring fees to enable use of the fee multiples at the valuation stage.

The age profile of clients is extremely important, as clients are generally more comfortable dealing with someone around their own age. A generation gap between the vendor and purchaser may affect the continuity of client fees and thus the purchase consideration.

Staff

The quality of an accountancy practice is dependent on both the principles and the staff who work in the practice. Unlike a normal employment situation a practice purchase affords the buyer the opportunity to independently review the quality of the staff and their work prior to employment without solely relying on information obtained from interview or references. Due to a combination of poor quality staff in a practice and the synergies that will be created through its acquisition, reducing staff numbers may become a necessity. Usually this responsibility to downsize falls to the seller as part of the final agreement prior to the transition period.

While the purchase of a practice is usually a sensitive issue and discretion is always required, it may be necessary to consult with key staff prior to finalising a purchase agreement. The continuing support of long established staff is essential to ensure the continuity of past fee income.

Finance

The availability of finance to the purchaser or the lack thereof, will impact considerably on the purchasing power of a potential buyer and indirectly the eventual valuation price. Accountants are however viewed as good target customers by financial institutions because of their potential. Practising accountants have a duality of purpose for banks; as customers in their own right and also as a source of future business. Regardless of the favourable view taken of accountancy practices lending institutions would generally expect purchasers to provide one third of the total purchase price from own funds. The bank would then provide the remaining two thirds of the purchase price in the form of a term loan over five to seven years. The repayment capacity of this term loan would generally be based upon capital repayments not exceeding 15% to 20% of pre-tax earnings. When calculated, this multiple for capital repayments would suggest that the valuation of a sole practice in bank terms should approximately be a multiple of twice the maintainable profits of the practice.

Due Diligence Process

The size, complexity and sensitivity of the practice being acquired will impact significantly on the due diligence process undertaken. Human nature dictates that many individuals are fiercely protective of their personal and business information, but the disclosure of pertinent information and a detailed due diligence are essential. Relevant information required includes:-

- Fee notes for the preceding 3 years
- Client profile review
- Staff quality review
- Fixtures, fittings and equipment schedules
- Practice location and premises suitability
- Client files
- Listing of fee finance and monthly standing order clients
- Aged debtors listing
- Work in progress listing
- Professional Indemnity Insurance Review
- Legal review including any pending litigation
- Cashflow analysis for the preceding 3 years
- Bank statements for the preceding 3 years
- P.35’s and Vat returns for the preceding 3 years
- Practice accounts for the preceding 3 years

Unfortunately sellers might be reluctant to impart with much of the information detailed above but the acquisition of an accountancy practice is no different from any business and the detailed review of most of the information listed is essential to enable the buyer to reach an informed decision on the purchase.

Pitfalls and Hazards

It is not possible to identify all the potential difficulties that may be encountered in purchasing an accountancy practice. Each transaction brings its own unique circumstances and both the seller and the buyer will need to be aware of the many pitfalls that they may encounter. Some potential areas of difficulty may include:
* Identifying time included in work in progress that has been previously billed as interim fees or paid in advance.

* Clients who pay by monthly standing order require a detailed review in order to assess the amount of time and work required to complete the file compared to the scope for additional billing.

* Discrepancies in staff charge out rates and billing levels between the purchasing and selling practice.

* Staff harmonization to ensure that all employees consistently apply work practices, procedures and standards.

* Attaining a consistent level of fee recovery across the new practice.

**Basis of Valuation**

The overall valuation is based upon a combination of all of the above particularly the scenario set out in relation to finance. Essentially a practice on sale in the open market is driven by the price the market is willing to offer. Invariably the sale of an accountancy practice is based upon a multiple of gross annual recurring fees. While there are no hard and fast rules for defining these multiples a generally accepted rule of thumb used in the valuation is set out below:

<table>
<thead>
<tr>
<th>Gross Annual Recurring Fees (Profiled by individual client)</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to €5,000</td>
<td>€0.75 per €1.00</td>
</tr>
<tr>
<td>€5,000 to €10,000</td>
<td>€1.00 per €1.00</td>
</tr>
<tr>
<td>Over €10,000</td>
<td>€1.25 per €1.00</td>
</tr>
</tbody>
</table>

The responsibility for the collection of debts usually falls to the vendor, but by agreement, for a set fee, the purchaser may collect the debts on behalf of the seller and pass on the proceeds as they are received.

The seller should always aim to minimize the value of work in progress at the execution date of the contract. Once the work in progress has been agreed the purchaser usually pays the vendor the value of the work in progress as the relevant fees are collected upon job completion.

Ideally the purchase of a practice should include a changeover period whereby the vendor and the purchaser work side by side in the new practice. The transition period has a dual beneficial effect of assisting the incoming accountant familiarise themselves with the clients while also minimizing the possibility of losing clients. Certain circumstances such as health, immigration and the seller’s career plan may dictate otherwise but a minimum transition period of 6 to 12 months has yielded positive results in the past.

The timing of payment is an essential part of the negotiation process and agreement can sometimes be difficult as there may be a direct conflict between the seller’s requirements for finance and the purchaser’s desire to meet these requirements. Underlying the finance issues a seller will naturally seek to maximise the short-term payments, while a purchaser will seek to extend the period and claw back conditions to protect their investment. As with valuation multiples there are no definitive terms but a commonly used payment structure is set out below:

* 40% of agreed purchase consideration payable on date of execution of agreement
* 30% of agreed purchase consideration 12 months after the date of execution
* 30% of agreed purchase consideration 24 months after the date of execution

The final 30% of the agreed purchase consideration will be reduced to reflect the loss of any clients not retained by the purchaser after 24 months. The claw back terms should reflect the original purchase valuation of the specific client.

**Purchase Agreement**

The agreement used for the sale of an accountancy practice obviously requires specific legal and taxation advice, tailored to reflect the exact circumstances of the acquisition, but some of the issues, which universally require consideration and mention, are set out below:
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- Purchase date and assets being sold
- Assumption of debts and liabilities of the practice
- Payment terms
- Claw back conditions
- Non-competition and assistance agreement
- Treatment of work in progress and debtors
- Terms of consultancy agreement during handover period
- Staffing considerations
- Arbitration stipulations

A New Practice is Born

Advising clients of the purchase and change in their professional advisors requires sensitivity and diplomacy. In developing any business relationship the initial contact can dictate the tone and nature of the relationship going forward. The generally accepted method is to write to all clients advising them of the change and identifying the benefits from their perspective. This communication should be issued on the headed paper of the new practice and signed by both the vendor and purchaser. Ideally personal meetings should be arranged for all clients as a method of introduction, but depending on the size of the acquired practice this may be extremely difficult.

The announcement of the successful purchase should be delivered to staff individually or as a group depending on their seniority and influence. Staff should be reassured of their position, while simultaneously identifying the benefits of the purchase from their perspective. As soon as possible, employees of the new practice should sign their employment contracts and be introduced to any revision in practice procedures.

The confidential nature of the accountancy profession dictates that a relatively low profile approach is invariably taken to the announcement of the purchase to the general public.

Conclusion

Regardless whether you are a buyer or a seller, buying or selling an accountancy practice is not an easy task. The seller must groom the practice and pre-empt the questions and queries a buyer will present. A buyer must ask the right questions to get the best value. The sale or purchase of a practice is one of the most important transactions an accountant is likely to undertake in their professional career and the process should be afforded the respect it deserves.

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This article is, with the permission of the author, based largely on the content of “Valuations, Mergers and Sales of Professional Practices” by Des Peelo.

Des Peelo has kindly provided 50 copies of the aforementioned publication for the first 50 readers who email Caroline Fry on cfry@cpaireland.ie and request a copy.

This article does not constitute legal or professional advice.