

SELLING AN ACCOUNTING PRACTICE CHECKLIST

INTRODUCTION

The purpose of this checklist is to outline how a principal in public practice can affect an orderly sale of their accountancy practice or parcel of fees.

In practical terms you can either:

- list your practice for sale with a specialised business broker who may charge a commission of up to approximately 7% of your gross annual fees or
- conduct your own advertising program and sell your practice privately.

CONTENTS

Decision-making timeline	3
Preliminary steps before listing for sale	4
Listing the sale of your practice	8
Documenting the negotiated sale	8
Handover	10
Appendix 1: To sell a parcel of fees under vendor terms (no initial outlay of capital)	13
Appendix 2: To sell equity in the firm to an employee / admit an employee as a partner	14
Appendix 3: Options to access the CGT small business concessions	16

DECISION-MAKING TIMELINE

Decision made to sell the practice or a parcel of fees	
List for sale with specialist business broker	Conduct own selling program
Prepare practice profile	
Prepare a confidentiality deed	
Determine your selling price	
Timing the sale	
Advertise	
Respond to enquiries	
Negotiate sale	
Drawing contracts	
Settlement	
Handover	

PRELIMINARY STEPS BEFORE LISTING FOR SALE

Prepare practice profile for potential buyers

This should consist of a detailed description of the practice with a title such as “Accountancy Practice for Sale” or “Accountancy Practice Information Memorandum” that will include:

Executive summary

A brief summary of the practice for sale, the sale price, any key terms required, and handover support being offered.

Background information

General comments about the firm including its history, team structure, mission, vision of the firm into the future, competitive advantages or points of differentiation, brief overview of professional services provided, the type & source of clients and geographical area serviced, a brief description of office premises and details of the technology employed.

Owners reason(s) for selling

The reason(s) and/or issue(s) that have brought about the decision to sell.

Business premises

Detail the exact address/es, surrounding environment and physical appearance of the office and whether there is room for expansion; whether the occupancy is available as tenant or owner, details of any lease agreement and options for renewal, also if parking is available for both clients and employees.

Services and/or products

Detailed list of all services and/or products currently being provided to clients and future services/products in planning stages. Advise if there are referral sources to the firm and whether any contracts exist to document the understanding of the arrangements e.g. who has ownership of the client and control of client service delivery and income sharing etc.

Suppliers

Detail the major types of suppliers to the firm including the expenses item covered, (e.g. subscriptions, software and licenses etc.). Include outsourced service providers for client work (e.g. audit, financial planning) as well as other service providers to the firm e.g. advertising, marketing, IT, etc.

Client analysis

- The firm's gross fee income for the last three completed years and the current year to date (including a budget for the balance of the year if applicable) with an apportionment of the income between the practice service areas (e.g. tax, accounting, audit, financial planning, consulting etc.) together with the percentage split on the same basis.
- Analysis of the firm's client base by segmentation – grouping the number of clients within value bands (according to fees generated) within the last completed year and grouping the number of clients according to the type of engagement completed (e.g. type of tax return completed etc.) and show the total number of clients and average fees per client.
- Client history/background – outline the firm's client selection criteria plus provide summary of the average client as to age group, tenure with firm, industry classification, geographical location, services currently being utilised and whether under fixed price agreements, what % of fees are paid in advance, and whether there are honorariums or pro bono assignments.

Financial analysis

- Profit and loss statement for the last three years and the current year to date (including a budget for the balance of the year if applicable) adjusted for vendor expense items
- Current balance sheet
- Details of fee income derived from large or one-off assignments (if any)
- Firm KPI report
- Plant & equipment and software registers
- Detail all current HP/lease and any other finance contracts
- Detail all prepaid expenses including subscriptions, insurances, rent, memberships etc.

Marketing plan

Detail plans currently in place for marketing the firm's services. This may include the strategies to procure new clients and any specific advertising or marketing strategies and contracts in place through all forms of the media.

Human resources

Include the following details about the firm's team-members:

- organisation chart showing job titles, areas of responsibility and reporting lines
- qualifications and specialisations/expertise
- years of experience
- total salaries and charge out rates, average weekly hours worked, average weekly hours charged, productivity %, WIP write-offs/ons
- accruals of annual leave, sick leave, long service leave and maternity/paternity leave entitlements and amounts taken etc.

All of the above information is very important to provide on behalf of the outgoing principal, as it will give a better indication to the prospective buyer as to how much time he/she will be required to commit to the fee generation and management of the existing firm and client base. Alternatively it will give an indication of the level of expertise and role(s) required to replace the outgoing principal with appropriate employee(s).

Technology applications

- Detail all computer hardware and software in use
- Detail each software program version and last upgrade
- Detail all telecommunication systems and lines currently in use i.e. telephone, facsimile, modems, etc.
- Detail website design, website hosting, eCommerce and ISP contractual arrangements.

Systemisation of operating procedures

List all currently used operations/procedures manuals including date of last update and whether in paper, electronic or web-based form.

Industry memberships

Detail all subscriptions and memberships to professional and industry associations and dates of expiry.

Library and references

Overview of books and other hard backed reference material in firm's library including other publications, subscriptions, journals, circulars, technical update services and indicate whether they are received and maintained in paper, CD, electronic or web-based form.

Industry outlook, economic and competitive environment

- Provide details of the current general or macro-economic conditions within the industry the firm operates within
- Provide additional details of the current micro economic geographical and regional issues and their application to the firm's future
- Include your vision of the firm of the future and its indicative outcomes against the future competitive landscape it will be operating within.

Key attractions of the firm and the buyer's opportunities

Outline why this firm has a superior benefit or advantage over other competitor firms for the prospective buyer (on a "What's in it for me" basis) and include client testimonials/references and other professional references/testimonials.

Prepare a deed of confidentiality and non-disclosure

It is important to have your legal advisor draft/review the document to ensure any potential buyer does not disclose or utilise any information obtained in the sale process that may damage your business. It is also important that you understand fully the principal who is purchasing your firm/client base from the point of view that it will be he/she to whom you will be introducing and entrusting your clients' needs and future. In which case you will need to have included in the confidentiality agreement the authority to obtain personal information about the incoming principal. Therein you will both be protected from potential misuse of confidential information. You must insist on any potential buyers signing this document before you provide them with the detailed practice profile you have prepared.

Determine the selling price for your practice

Introduction

The selling price is normally based on your annual gross fee income adjusted according to the analysis of your client base and fee structure. Your sale price may be quoted as (so many) 'cents in the dollar' of annual gross fees net of GST. This is a rather simplistic if not 'subjective' method of valuing your practice, especially when the buyer is more interested in the bottom line because it is from the profit/cash-flow that the buyer will obtain an investment return. Your sale price should be influenced by the market for practices of your type. You need to source this type of market information. Whilst valuation of your practice is an important piece of information in understanding an appropriate price for the firm, price and value are not the same thing and typically price will trade at a premium or discount to value.

Calculation methodologies

Small accounting firms will either be valued under an industry method or a capitalization of future maintainable earnings. The industry method for accounting firms values them at a number of cents in the dollar of maintainable revenue. Currently the most common range for value is between 80 cents to \$1 in the dollar of maintainable fees. This methodology normally only applies to firms whose maintainable revenues are less than \$1m per annum. It should be noted that it is possible for values to fall either above or below the normal range based on the risk profile of the practice.

Once a firm's revenue exceeds \$1m per annum it is more likely to be valued on a capitalization of maintainable earnings method. This method establishes the maintainable earnings of the practice (not net profit) after allowance for a reasonable partner salary and then applies a capitalisation rate or earnings multiple that reflects the risk profile of the firm. Currently earnings multiples for reasonable quality accounting firms fall in the range of 3.6 to 4.2 times. The resultant sum represents the firm's market value. This market value is made up of various assets including office equipment, library, IP and goodwill but excluding debtors and WIP.

Retention clause / claw-back provision

When buying an accounting practice, or a parcel of fees, a purchaser may require some guarantee that the clients purchased will stay with the new owner for a period (generally one and not more than two years) so that they can achieve a return on their investment.

One way of doing this is to have a clause in the sale agreement that allows for the retention of part of the sale price (usually 10-20%) which will only be paid if a set percentage of the maintainable fees are achieved for a period of time. Fees falling below the maintainable earnings agreed in the sale contract will cause a reduction in the sale price.

This is sometimes called a 'claw-back' as the purchaser is clawing back the cost of clients purchased that did not transfer for some reason. This retention, or claw-back, is an incentive to the seller to ensure that the clients continue with the purchaser. It is also a protection for the purchaser of the asset he/she is buying. Typically, with a claw back there is either a deferred settlement for the claw back amount or the funds are held in an escrow account pending completion of the claw back period. This forms a part of contract negotiations.

EXAMPLE

Bill Bloggs is buying the accountancy practice of Jeff Jones for \$300,000. Total fees are \$400,000. The vendor agrees that maintainable revenue for the next year following the sale will be \$400,000 and in the event that it is less than that amount, then a claw back of 75% of the difference between \$400,000 and the fees earned for that year will apply, to a maximum of \$30,000. In the year following the sale earned fees were \$390,000. The purchaser exercised their right under the claw back and the sale price was adjusted downwards by \$7,500.

LISTING THE SALE OF YOUR PRACTICE

Timing

The best times to attract potential buyers are generally at the start of each calendar year and before the commencement of the new financial year.

It is suggested you keep your intention of selling your business confidential in the initial stages. You can inform your staff and clients of your plans at an appropriate time later in the process.

Advertising

CPA Australia's magazines

Place a paid advertisement in CPA Australia's monthly magazine, INTHEBLACK, or in CPA Australia's INPRACTICE and INTHEBLACK eNewsletters. For INTHEBLACK, this should be renewed for at least three months. You will see many examples in the back of the magazines to help guide you in wording your advertisement.

Use a CPA box number

Use the CPA box number to avoid having to identify yourself at the early stages.

Respond to enquiries

Initial responses

When you receive responses to your advertisement, it is suggested you personally telephone each applicant to determine if the enquirer is an appropriate buyer for your practice. This will avoid unnecessarily revealing confidential information about your practice to inappropriate persons and will also assist in you identifying genuine and qualified sale prospects. A sample list of questions are attached at Appendix 1 to assist you in identifying prospective buyer(s).

Supply of practice information

Suitable prospective buyers may then be provided with your prepared practice profile provided they have first signed your confidentiality deed.

DOCUMENTING THE NEGOTIATED SALE

Heads of agreement

Once negotiations have been finalised, draft and sign (in consultation with the buyer) a Heads of Agreement, setting out all of the relevant terms and conditions to be provided to your respective solicitors to prepare the final contract documents.

Contract issues

Issues to consider when completing the finer points in the contract may include the following.

Due diligence

- Due diligence issues may include inspection of client files, timing and trust account audits etc.

Staff entitlements

- Staff entitlements and other issues include annual leave, sick leave, bonuses, long service and maternity leave. Staff entitlements typically transfer to the new owner. There may be an adjustment in the sale consideration to allow for the liability transferred.

Restraint of trade

- Restraint of trade requirements from the buyer's perspective but take into account the vendor's rights to obtain employment elsewhere.

Practice familiarisation

- Practice familiarisation and notification including introduction to clients during the changeover period.

Period of continuance

- Period of continuance for the exiting principal and the duty of care of the incoming principal.

Retention clause

- Retention specifies a percentage of the purchase price to be retained by the purchaser/held in trust for a certain period to guarantee continuation of client base/fees.

Transfer of business name

- Detail the transfer of business name, if required or applicable.

Sale or transfer of shares

- Sale or transfer of shares includes the resignation of the company officer if the practice is an incorporated practice.

Office lease

- Assignment of office lease and other premises issues, as applicable. However, it is recommended to have this finalised so that liabilities do not arise in the future.

Equipment leases

- Assignment of equipment leases and other finance obligations, as applicable. However, it is better to have the buyer enter into fresh arrangements if at all possible.

Risk management

- Risk management plans on client selection and maintenance will give a better indication of your good management and will assist in you demanding a better sale price.

Indemnities

- Indemnities in respect to future claims, professional indemnity insurance continuity cover and run-off cover, if applicable for the exiting principal. This is very important to secure so that any disputes that may arise within the statute of limitations can be covered. Remember to notify the current underwriter of any change in circumstances or other client issues you may be aware of.

Privacy

- Privacy laws must be complied with before, during and after the entire negotiations. It is in your interest to ensure you have a sign-off from your clients before you allow the buyer to review client files or undertake a due diligence process.

Competition and Consumer Act

- Competition and Consumer Act breaches or misrepresentations by the practice should be disclosed and available for review by the buyer as it may cause your settlement to fail or your retention funds to be withheld on the grounds that you did not comply with the legal requirements of trading.

Public notifications

- Ensure all necessary notifications to the public and other regulators are made and published for both the exiting and incoming practitioner. This will enable suppliers/creditors to know that you no longer have anything to do with the ongoing firm's financial obligations.

Bank accounts

- Details of bank accounts including trust account operation and auditing issues.

Intellectual property

- Assignment of any intellectual property rights etc. e.g. brands.

Website

- Operation of the practice website, as applicable, including registration or assignment of domain name(s).

Occupational health and safety

- Any occupational health and safety issues should be clearly documented for the buyer.

Legal issues

- All outstanding legal issues involving the firm that have been levelled at you as principal of the firm should be disclosed.

Referencing of entities

- Ensure the entities/owners and structures are referred to correctly in the documentation so that accurate exit strategies are utilised and maximised for tax and other legal purposes. In this regard practitioners should be aware of the CGT small business concessions and how they might gain access to them through proper structuring of their practice and in completing the required legal documentation. A basic overview of the rules pertaining to these concessions is attached at Appendix 4. These should be used only as a guide and are not to be considered complete. Practitioners who operate through a company or unit trust need to take care when completing the documentation as to whether they are selling the business assets or their shares/units as different rules apply to each situation.

Screening buyers

- Be careful when providing buyers with vendor finance and ensure you have thoroughly screened the buyer and their references etc. Ideally, do not provide vendor finance. Although you may take a charge over the assets of the firm to protect your loan funds, in the event of the buyer defaulting and you need to step back in, just be aware that he/she may have already damaged the firm's goodwill to the point where you could find your asset has either greatly diminished or even disappeared.

HANDOVER

Introduction to clients

Most arrangements will require the vendor to be available for a period of time to introduce the new owner of your practice to the clients and staff. How this process is handled is important to ensure the maintenance of the client base, the staff and the eventual release of the retention monies in the future.

Usually a letter is sent to all clients advising them of the ownership transfer giving a profile of the new principal/owner and inviting them to a function (e.g. informal cocktail party) where both the existing and new principals are present along with all the staff. Alternatively, it may be sufficient to follow up with each client (major ones) on a one on one basis to instill confidence in the process.

Familiarisation with office procedures and systems

You need to ensure the new buyer reviews the practice procedures and systems again on handover when practice manuals are provided under the agreement. This will enable the clients to maintain their usual method of interaction with the firm and minimise the disruption to their routine and are more likely to feel the seamless transition. It will also ensure the buyer is totally familiar with how you do business until such time as he/she begins developing their own way of doing things and making changes with the clients.

Employee records

Employee records should be discussed with the buyer and new employment letters prepared by the buyer or purchasing entity. This is important where agreed action with employees has been entered into from previous performance appraisals and is pending and especially where disciplinary or harassment issues remain outstanding. Where employees are transferring to the new owners, the vendor should ensure that letters of offer of employment, on terms no less than existing, are provided to staff in advance of any sale being completed. This will assist in avoiding any claims of constructive redundancy.

Notifications to relevant/interested parties

Ensure that the buyer takes responsibility to notify the following parties:

- ATO of transfer of clients to new tax agent listing
- ASIC of any relevant changes
- CPA Australia and any other relevant bodies.

It is wise to ensure that all your regulatory registrations and client lists etc. have been transferred or cancelled so that you are no longer personally responsible for their compliance issues.

More importantly you need to ensure that all third parties under contractual arrangements are either notified of the change to the new buyer or alternatively you ensure the contract is severed/finalised on your part especially with any financial or legal obligations required to be borne by you.

APPENDIX 1

To sell a parcel of fees under vendor terms (no initial outlay of capital)

Value of the parcel

Amount based on a percentage of revenue collected in the first year of transfer, generally in line with the revenue collected in the previous year by the seller.

Method of payment

The payment of the purchase price is made during the first year on the following basis:

- during year one – pay to vendor 50% of revenue collected
- end of year one/start of year two – pay the balance of 50% (in a lump sum).

Advantages

This approach has the following benefits:

- purchaser only pays for the clients who permanently transfer to their practice
- no requirement for an immediate outlay of capital or alternative financing
- it is in the best interests of the seller that the clients transfer permanently to the purchaser
- it is also in the best interests of the purchaser that they satisfy the needs of the new clients to ensure their fees are maintained under the agreement during the second and subsequent years.

Disadvantages

Generally, in this scenario the percentage of fees for the sale/purchase consideration is higher than the percentage paid in the scenario where the purchase price is all paid up front (with a retention amount).

Important

Please be aware that an arrangement to sell a parcel of fees (compared to an entire practice) may jeopardise your ability to access all the benefits of the CGT small business concessions, as a parcel of fees may not meet the requirements under the rules. Further, the sale of a parcel of fees will not satisfy the GST-free conditions of the sale of a going concern. Accordingly, GST is likely to be payable on the sale of a parcel of fees.

The above is only one payment methodology and it is recommended that you consider other options that may better suit your needs and objectives along with addressing all the other points included in the main body of this document.

APPENDIX 2

To sell equity in the firm to an employee / admit an employee as a partner

Objective

Provide an effective methodology where an employee can be admitted as a partner and where the existing partner(s) can be paid for their goodwill in the firm.

Background

It is preferable that the incoming partner sources their own funding for the full purchase price rather than the existing partner(s) having to provide support, however this will obviously depend upon their individual financial resources.

It is also becoming commonplace to take in as a partner younger accountants who do not have the financial resources nor wish to take on an individual burden of debt to buy a substantial share in a practice (of say 20%-50%). They are more content to assume a salaried partner role with or without a performance bonus or to acquire a smaller share of equity in the firm (say 5%-15%).

Therefore, if exiting partners are keen to have an exit strategy in place to cash-up their goodwill they must develop new ways of funding an incoming partner/existing partners.

This need to have a strategy in place is being driven by the scenario that in another ten years or so approximately 25% of current practitioners will be at retirement age. An increasing number of vendors coming on to the market could act to depress prices or limit some sales. Having a plan in place earlier may assist in mitigating this risk.

Firm valuation model

Some larger firms have adopted a model of valuing the goodwill of their practice at the end of every financial year as part of their risk management/succession planning strategies. In so doing they have a ready mechanism that allows for an easy identification of the sums to insure/reinsure the partners (under buy/sell agreements) in the event of an unexpected tragedy. In addition, it is a transparent and effective mechanism of establishing the value for the transfer of goodwill between incoming and outgoing partners. As all partners agree to the valuation model and the succession planning strategy as part of their partnership agreement, it makes the whole process so much easier to administer. Thus when a new partner is admitted or one is retired they both know exactly how much consideration they will be expected to pay for/receive.

These models are typically more generous than what would otherwise apply in an arms-length or third party sale as recognition of the value that the incoming partner has contributed to the firm over the years as an employee.

Leveraging the firm's equity via debt financing

A commonly used method in assisting incoming partner(s) equity is via debt funding. A charge is taken over the assets of the firm, or preferably the incoming partner's share, and the existing partner(s) receive the proceeds of the funding in proportion to their existing equity. However, the incoming partner is responsible for the debt (as the loan is in his/her name) and must service it from his/her share of the profits. Major lenders will fund up to 60% of the goodwill value of the firm (assuming the firm meets the lending criteria) and debt payments/funding

must be made from the incoming partner(s) profits. Increasingly, banks are looking to lend on a multiple of EBITDA of a firm – better performing firms will have greater capacity to finance these type of arrangements.

A downside of this method is that the lenders normally require all partners to become guarantors (jointly and severally liable) for the loan. However, assuming the partners have appropriately applied asset protection strategies, this generally speaking, works well.

Vendor financing

This is another alternative method of funding an incoming partner where the existing partners are still in a position to control/direct/maintain the operations of the firm and have some meaningful input to ensure they are paid back through client retention and growth. It does work well where it is difficult to ensure a succession plan through no other mechanism. Obviously, there is no additional cash injection other than via the usual organic growth in fees etc. but it is effective in securing a key person to the firm over the longer-term where required. Structured effectively with attaching key performance hurdles and/or bonuses, it can certainly free up existing partner(s) time for other areas of focus or even semi-retirement.

The disadvantages are on the risks of ownership and the fact that management of the firm still rests with the existing partners, who now have to share the profits with another partner. CGT issues need to be carefully managed if using this method, as there may not be the cash available to fund a CGT liability should one arise.

Scenario 1

Joe, Fred and Bob are partners in a firm with the following attributes:

Firm EBIT = \$450K

Goodwill Value = \$1.8M,

Partner equity (33.33% each) = \$600K

As part of their succession plan, Tom (currently a senior manager in the firm) is seeking partnership status and willing to take up equity in the firm. However, in this scenario he only has \$180k in available resources to pay the existing partners for his share of the firm's equity.

A normal agreement would include the following:

Tom is only entitled to a 10% equity share (\$180K/\$1.8M goodwill value) and the three partners would each receive \$60K as consideration for the sale of 10% of their existing one-third equity.

Scenario 2

What if Tom did not have any funds at all and he also requests a 25% equity share with the ability to leverage off the existing partners. The arrangements would include the following:

Tom will borrow the \$450K required to take his equity to a 25% share (with a security charge over the firm's goodwill).

Joe, Fred and Bob will each receive \$150K from the proceeds of Tom's bank loan of \$450K.

Each existing partner's equity would reduce from \$600K to \$450K (being 25% x \$1.8M).

Tom funds the repayments on his loan from the proceeds of his profit split of \$112.5K (being 25% x \$450K EBIT)

APPENDIX 4

Options to access the CGT small business concession

Where a business is sold, a capital gain is made, and certain conditions are met, there are potentially four CGT concessions that may be available to reduce the amount of CGT payable. These concessions are in addition to the general 50% CGT discount (if available).

The concessions are as follows:

1. [the 15-year exemption](#)
2. [the 50% active asset reduction](#)
3. [the retirement exemption](#)
4. [the rollover concession](#).

In addition to the tests above, a number of the concessions may only be available if additional conditions are satisfied.

Method statement

The calculation of the net capital gain applicable under the above concessions is as follows:

Step 1	Determine whether you satisfy the basic conditions for the small business CGT concessions. If 'YES' go to Step 2. If 'NO', you don't qualify for any of the small business CGT concessions. You may be eligible for the CGT discount. Go to Step 3.
Step 2	Determine whether you qualify for the small business 15-year exemption (not relevant to capital gains from depreciating assets). If 'YES' disregard the entire capital gain. You don't need to apply any of the other CGT concessions. If 'NO', go to Step 3.
Step 3	Offset any capital losses against the capital gain.
Step 4	Determine if you are eligible for the CGT discount. If so, reduce the remaining capital gain.
Step 5	Determine if the capital gain is from a depreciating asset used at least partly for a non-taxable purpose. If so, you are not eligible for any other concessions and can't reduce your capital gain any further.
Step 6	Determine if you qualify for the small business 50% active asset reduction (if you answered yes at Step 1 you will qualify). If so, reduce the remaining capital gain. You can choose not to apply the 50% active asset reduction and go straight to the small business retirement exemption or rollover in Step 7.
Step 7	Determine if you qualify for the small business retirement exemption or rollover. If so, reduce the remaining capital gain.
Step 8	Amount remaining equals the net capital gain to be included in your assessable income for the year.

This document is provided as a guide to some of the matters to be considered in selling an accounting practice. The guide is not intended to be exhaustive, nor complete. The methodology of a sale and all related issues that need to be considered will differ between each practice. It is recommended that the appropriate level of professional assistance and advice be sought prior to finalising any documentation.

Copyright © CPA Australia Ltd (“CPA Australia”) (ABN 64 008 392 452) 2017.

Disclaimer

CPA Australia Ltd has used reasonable care and skill in compiling the content of this material. However, CPA Australia Ltd makes no warranty as to the accuracy or completeness of any information in these materials. The above material is only general in nature and not intended to be specific to the reader’s circumstances. Further, as laws change frequently, all practitioners, readers, viewers and users are advised to undertake their own research or to seek professional advice before making any decisions or relying on the information provided.

November 2017