THE NEXT GENERATION

Valuing the Smaller Accounting Firm

By Joel Sinkin

For many smaller practitioners, their firm is one of their largest assets. They have worked for years to develop and nurture this practice and want to receive a reward for their sweat equity and loyalty. How do you value this asset?

Location, of course, is a factor. If you are in a geographic area where there are very few accounting firms, the supply-demand curve works against you. Obviously, if there are not many potential successors to your firm, the market will be soft. Therefore, this article will focus mainly on the important variables in areas where there is a reasonable supply of potential buyers.

Geography aside, there's good news for smaller firms in terms of overall demand. Although the medium and large firms have fallen significantly in value, small firms have experienced a smaller decline. The drop itself generally reflects the staffing shortage and the aging of the baby boomers, which has brought a larger number of sellers into the marketplace.

Most accounting firms are sold on a multiple of gross billings. The real question is: What are the variables that affect that multiple?

Down payment amount. The upfront payment can range from zero to 100% of the anticipated purchase price, but at the effective date of the deal the overwhelming majority of deals have a down payment in the range of 10% to 25%. Many aspects can and will affect this number beyond the depth of the buyer's pockets. Two large factors are the time of year of the closing and the treatment of the accounts receivable. A practice that generates the lion's share of its revenues during tax season may get a larger down payment in December than a buyer may be willing to provide in June. If a seller has an unusual amount of accounts receivable and wants to collect them before the buyer takes over, this too can affect the down payment percentage. Thus, the seller can use timing to influence the down payment.

The profitability of the deal for the buyer. The seller's personal net from the firm is not necessarily a good basis to calculate the value of a practice. Here's why: Let's assume the seller operates from his home, handles all the work himself and has a net of 85%. At some time in the future, the practitioner elects to take on an external office and hire some support staff. In which case is the practice worth more money?

The value of the firm depends on the value the buyer receives. If a buyer can integrate your practice into its current infrastructure with no incremental increases in overhead, clearly that is more profitable than taking on a satellite office and staff they do not need. This will affect the amount the buyer can afford to pay and still realize a profit. So, the key consideration for most buyers is what *their* net will be. This includes the tax ramifications. A seller will not receive the same value for the firm if the deal is structured as a 100% capital gain (unless the payout is also 15 years) as would be the case if all or a percentage was structured to provide the successor firm a current deduction.

Length of guarantee or retention period. The overwhelming majority of practices sold include a guarantee or retention period that adjusts the balance due to the seller based on actual client retention and collection of fees post closing. These periods can be as short as one tax season or they can run the entire duration of the payout period. In rare circumstances, there are no retention periods.

Length of the payout period. The longer the payout, traditionally the lower the monthly payment, the greater the cash flow. Most payout periods are between 3 and 10 years, with the highest percentage between 4 and 6 years—but there are exceptions to all these rules.

Multiple. Most practitioners want to know what the multiple should be. The multiple is the product of the rest of the variables. In the simplest of terms, the longer the payout and retention periods, and the more profitable the deal is for the buyer, the less cash upfront, the higher the multiple. Obviously the opposite is true, as well.

There are of course other factors that play into the value. These include but are not limited to cross selling opportunities and hard assets that may be included in the sale, as well as staff that come along with the deal. Given the horrific staffing situation many firms are experiencing, good quality staff can actually make a practice more attractive to many firms today.

Although a remote location can work against you, location can be an asset when a potential buyer wants to expand into another marketplace. Your client base is another factor. A practice that has many young, healthy, growing clients and businesses is likely to receive a

back to top

higher offer from a buyer than a practice with all aging clients who themselves are closing in on succession.

Remember that a good deal is a fair deal. Finding the happy compromise where the seller receives an appropriate reward for their years of work and the buyer makes a profit is the key to establishing a win/win deal.

Maximizing the value in your firm strongly depends on choosing the "right" successor. The buyer who retains your clients is, in most cases, the one who will be the most profitable for the seller. Once the right buyer is found, creating a transition plan that retains clients—and in cases where it is appropriate for the staff—is equally as critical. We'll address that topic in an upcoming issue.

Joel Sinkin (jsinkin@transitionadvisors.com) is a partner in Accounting Transition Advisors, LLC, which exclusively consults on the merger & acquisition of accounting practices nationally. He teaches CPE for state and national accounting associations and has consulted on over 900 accounting firm closings and succession plans and published books and articles nationally. He can be reached at 866-279-8550 or at www.transitionadvisors.com.

AWARDS FOR *SMALL FIRM SOLUTIONS*

The AICPA's *Small Firm Solutions* has recently won two prestigious awards. The newsletter won a Gold Award in the prestigious Hermes Creative Awards and an Award of Distinction in the esteemed Communicator Awards. Both are international competitions that recognize excellence in communications. The first two issues of *Small Firm Solutions* have received over 100,000 downloads from the PCPS Firm Practice Center (www.aicpa.org/pcps).

back to top

SMALL FIRM SOLUTIONS *is a quarterly e-newsletter designed to help AICPA members in the smallest firms make the most of their opportunities and keep track of important developments in the profession. It offers news updates as well as articles with practical solutions to common practice challenges.*

Editorial Advisory Board

THIS IS A PUBLICATION OF THE AICPA'S PRIVATE COMPANIES PRACTICE SECTION

back to top

ISO Certified