Many situations arise where the owner of a small or medium-sized CPA practice decides to sell the business or buy another one. Changes in the ownership of a practice raise many questions, because this is one of the most challenging situations that can arise for the owners of firms of moderate size. CPAs are experts in many financial areas, but buying or selling a practice is not usually one of those. Consequently, sound preparation for the transfer of the firm is essential for the buyer and seller to have a successful transaction.

Why do owners want to sell their practices? CPAs who have devoted years of their lives to building a practice face a difficult situation if they decide to sell their firm. They have invested much personal capital in establishing and growing the business, and often develop a deep sense of attachment.

However, there are valid reasons that may cause even the most devoted owner to consider selling his/her practice. The CPA may decide to exit because of age, retirement or health issues. Others may be unable to cope as small business owners since they must perform all the functions of management, such as finance and marketing, in addition to being technical experts in their area of practice. Some CPAs may decide that a career change is right for them. Also, the estate of a deceased CPA may be forced to sell the practice.

Why do others want to buy CPA practices? CPAs may decide to buy a practice for a variety of reasons. They may want to begin a new business and see the purchase of an existing one as a viable way to jumpstart a new practice. They may want to expand their existing firm, establish a successor or eliminate competition. One thing that both the potential buyer and the potential seller should realize up front is that the exchange process will take a fairly long period of time and the timing of the sale is of great importance. Consequently, patience will be required of both the buyer and seller while the sale is being processed and closed.

Ways to Sell

After a CPA decides to sell, the next step is to choose the method that will be used to sell the practice. The two most common methods are using a broker or an agent and sale by the owner. There are several brokers who specialize in selling CPA firms and
they can be located on the Internet. There are both advantages and disadvantages to each method. Advantages to using a broker include the professional experience of the broker and expertise with the advertising methods used. The big disadvantage to using a broker is the necessity of paying a commission to the broker, reducing the profit for the seller.

Some advantages of sale by owner are direct contact with the buyer and the flexibility to structure the sale. Disadvantages to sale by the owner are lack of expertise by the owner in marketing and in structuring the details of the sale. A CPA who decides to sell the practice personally may use a variety of techniques to attract potential buyers. These include direct mail, advertisements in CPA journals, and referrals from other practitioners.

**Valuing the Practice**

An issue of prime importance for a CPA selling a practice is how to value the business. A common method is to value the practice based on a multiple of the yearly revenues of the firm. The most common multiple is one times the yearly revenue. For instance, if the firm has annual revenues of $200,000, the negotiated purchase price would be $200,000 using a multiple of one. Generally, a practice that is in a good location or has other attractive qualities will sell at a bonus over the multiple of one, while a firm in a poor location will sell for less than a multiple of one. For instance, tax practices located in affluent suburbs with residents who are successful professionals, and auditing practices located near growing and successful small and medium-sized businesses would probably command a bonus percentage.

The seller and buyer may be interested in transferring other assets, as well as client accounts in a turnkey transaction. The buyer might wish to assume the seller’s leases on buildings and equipment and/or retain the seller’s employees. This type of transaction would require appropriate appraisals of the other tangible assets.

A variable price base on future fees might expand the buyer pool from the continued on next page
standpoint of the seller. The buyer would probably look on such an arrangement favorably. Such an arrangement could be based on the percentage of clients retained by the purchasing firm over the next few years. For instance, if the seller is billing $200,000 per year, the buyer might agree to pay 20 percent down at closing and future payments will be based on the billings collected from the seller’s former clients. This type of arrangement is most advantageous for the buyer. Two problems associated with variable pricing are the motivation of the seller to retain all of the purchased clients and the seller’s inability to verify the future billings.

Terms of Sale

A successful transfer of a CPA practice from the seller to the buyer requires that the terms of the sale, such as the timing of the payments, the financing of the sale, the provisions of a non-competitive agreement, and the process of due diligence be clearly stated in the agreement.

The timing of the payments will be one of the most difficult aspects of the sale to negotiate. Naturally, the seller wishes to negotiate payments that will maximize their early cash inflow, while the buyer will seek to stretch out the payments as long as possible to minimize their cash outflow.

Both the buyer and seller must carefully consider the tax implications of the agreement. The two most important considerations are the classification of the assets as long-term capital gain property or ordinary income property, and the timing of the payments for tax purposes. The seller might find it advantageous to stretch out the payments so that installment treatment will be possible.

The timing of the payments is directly related to financing. The terms might range from a 100 percent payment by the buyer to 100 percent financing by the seller. The buyer will most likely want to arrange financing by the seller. Other alternatives will be financing through regular credit channels, such as banks and finance companies.

In almost all cases, the buyer will insist on a non-competition agreement to protect their new assets. The major provisions of the agreement will relate to time and distance. For instance, the seller might agree not to start a new practice within a radius of 100 miles or to serve any of the existing clients for five years. There might also be a provision that the seller will not serve any of the existing out-of-area clients as a way to enforce the distance provision.

Due diligence refers to the process of the buyer verifying the financial data that the seller purports to be true about the practice. Since two or more CPAs who are experts in financial matters are involved, this process can be simple or complicated, depending on the individuals involved. The buyer generally needs to verify revenue, seasonal cash flows, the makeup of the client base, and billing rates, while the seller needs to provide access to the appropriate records while maintaining client confidentiality.

Timing of Sale

Smaller CPA firms usually derive a large percentage of their revenues from tax preparation. Consequently, the ideal time for such a firm to make the transfer would be after completion of the busy season. Two target dates could be April 15 and Oct. 15. Of course, if the practice has a substantial percentage of other services like compilations or write ups, the timing should be adjusted.

One of the most important things for the buyer to consider is providing for a transition year(s). The buyer will have a much higher probability of retaining the purchased clients if the seller assists with the transition. In a small or medium-sized firm, clients will likely have a personal relationship with the owner of the firm. The seller could agree to continue to work with the buyer for a period of time to provide an adjustment period for the clients and thus the retention of clients will be enhanced.

The buyer and seller should send a joint communication to clients as soon as possible after closing the sale to inform clients of the transaction. This letter will be a critical feature as it is the first knowledge the clients will have of the sale and will contribute greatly to the future relationship with the new owner. The seller also needs to verify the professional credentials of the buyer before the seller vouches for the buyer to the clients.

Careful structuring of the sale and transfer of the practice plus a well-planned transition period will increase the likelihood that the transferred clients will remain with the new owner. Of course, the most important factor in client retention will be the quality of the service rendered by the purchasing CPA.

Problems may arise when billing rates differ between buyer and seller. A larger firm may have difficulty consolidating and integrating the accounts of a smaller firm, because the clients may be reluctant to pay the higher billing rates. The clients of a smaller practice may also have difficulty adjusting to the larger firm since they are used to more interaction with the smaller firm’s owners and partners.

A buying CPA who specializes in one field such as write-up or investment advising might have a difficult time integrating another practice that specializes in another field such as taxation.

An agreement needs to be reached on the billing and completion of work-in-process to insure that the work is completed in a satisfactory manner and that there will be no dispute on the billing. A well-structured transition agreement will eliminate this problem.

The Final Goal: Order and Profit

Buying or selling a CPA practice is one of the most significant events that can occur in the career of a CPA. A well-structured sale can be profitable and enjoyable for both parties. A sound sales agreement should lead to an orderly transition period, which will lead to contented buyers, sellers and clients.