Five fatal errors when buying accountancy practices

(And how to avoid them)
Making a business acquisition is an exciting time for a business owner. The potential for growth, achieving synergies and developing your practice in new ways is incredible – if you do it right.

And many firms have done it right, over the course of time, achieving scale through a carefully considered mixture of organic growth and strategic acquisitions. Think of the largest accountancy firm in the UK, PricewaterhouseCoopers, which, according to Accountancy Age’s 2011 figures, is ranked 1 out of all UK practices, based on fee income.

At the end of 2011, PWC recorded £2.33bn fee income from its 845 partners – a great result for a company that started life as two separate entrepreneurial firms in the mid-1800s (see below).

However, not all practice mergers go well and for every one that succeeds, several others fall by the wayside, failing to achieve the synergies necessary to make an acquisition work.

The last thing a prospective buyer wants is to realise he has paid over the odds for something that cannot deliver on what it promised.

This guide aims to highlight five common pitfalls into which the unwary buyer could fall, and to help you avoid them.

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**Birth of a brand**

1849
Samuel Lowell Price sets up in business in London.

1854
William Cooper establishes his own practice in London, which seven years later becomes Cooper Brothers.

1865
Price, Holyland and Waterhouse join forces in partnership

1874
Name changes to Price, Waterhouse & Co.

1898

1957
Cooper Brothers & Co (UK), McDonald, Currie and Co (Canada) and Lybrand, Ross Bros & Montgomery (US) merge to form Coopers & Lybrand.

1982
Price Waterhouse World Firm formed.

1990
merges with Deloitte & Touche in a number of countries around the world

1998
Worldwide merger of Price Waterhouse and Coopers & Lybrand to create PricewaterhouseCoopers.

2010
PricewaterhouseCoopers formally shortened its brand name to pwc.

Source: PwC
Although there are similarities between the thousands of accountancy practices across the UK, such as the mix of services, notice to reader, review and audit engagements, tax return completion and so on, the reality is that few practices are the same.

Smaller firms tend to lean toward notice to reader engagements and larger firms may favour audit work. Some firms are family-run and family-owned and believe in preserving a heritage. Others are entrepreneurial start-ups or partnership structures.

Some practices engage with marketing themselves or embracing technology to help them do more, more efficiently, and engage with a wider audience. Other firms like to keep it small, keep it local and keep it personal.

When buying any practice, therefore, you are not just buying a book of clients, you are buying a book of people that are used to being dealt with and serviced in a particular way.

When absorbing a new firm into your own practice, how will you manage any staff expectations – or staff redundancies? How will you deal with any partners that have come with the package?

Will you be able to use this acquisition to achieve your ambitions or will you find out that you have bought a white elephant? You need first to set out your goals, your plans, your strategy for growth and then see what you will need from any potential acquisition.

After this, you need to do some digging, find out everything you can, look out for any compliance issues or post-sale obstacles, all while continuing to put the client first.

1) Think ‘synergy’, not ‘shoe horn’

You may be on the hunt for a practice that has complementary skill sets and services to that of your own. There are, after all, many different specialisms within accountancy, from auditing to corporate taxation and it is tempting to think of this as a bolt-on to your existing practice.

Or you may be looking for a firm that can help you gain market share in a particular locality, so your intention is not to bolt this new practice in, but to subsume it within your brand.

Either way, you must think ‘synergy’ not ‘shoehorn’. Sometimes the temptation to take advantage of a particular situation – a distressed accountancy practice perhaps from whom you can buy client books at a discount – can lead you into making an inappropriate purchase that could scupper your business plans.

Whether you are buying to expand services or to expand reach, acquiring an accountancy practice has the potential to produce many synergies, and these are important things to consider as part of the overall deal.

Things to consider include:

• The scope for increased productivity
• Reduced overheads
• Increased expertise and specialisms
• Reduction in staff numbers or rearrangement of staff roles
• Economic use of equipment and software
• Improved quality of service
• Potential reduction in office space and costs – does your office have space to absorb another practice? Or perhaps their office has more room for development and is more strategically placed?

All these things can have an effect on the multiples used and the eventual valuation of the purchase price, so it is important to think ‘synergy’ rather than to shoehorn another practice and struggle to bring it into line to help achieve your vision for your practice.
2) Due Diligence ... and why it is vital
Imagine going into a clothes shop and selecting a shirt based on colour alone, without checking its size first, whether the style fits and whether it will work well with any of your other clothes.

In this instance, even if you don’t check the label, you have recourse under various retail acts to take it back to the store for a refund or exchange.

However you cannot simply return an accountancy practice after purchase so it is absolutely vital that you not only examine the label, check the various working styles and consider whether it will fit well into your practice, but you need to verify each bit of information to check the firm is what its owner says it is. In the early stages of any acquisition process, you should be given enough information to make a qualified judgement about whether you think the practice is as valuable as the exiting owner says it is, and whether it will generate revenue for you.

Initial information you might expect to see, if not in detail for the sake of confidentiality at this stage, includes:

• Fee base retained after three years.
• Number of existing clients.
• Cost of fee base per calculations.
• The percentage of your fee increases implemented over three years.
• Additional services provided to these clients annually.
• New clients referred over three years.
• Total gross revenues of the firm after three years.
• Net cost per £1 revenue based on cost of fee base.

But once you have made a decision to proceed with this particular practice, and you sign a letter of confidentiality and confirm you have the funds available practice, you should then start gathering as much information as possible.

You need to dig deeper into exactly how the practice earns its keep, what sort of client retention it has, and what the potential business risks might be.

The list of things to look out for and consider when conducting a due diligence exercise is long and, as Box 1 declares, it is not exhaustive. But it is a good starting-point. One seasoned trade buyer once said: “We are naturally inquisitive as humans but when it comes to buying, you need to make sure that you ask all the right questions. A seller has to tell you the answer to what you ask: so think of the questions that you haven’t asked, and consider what the seller might not be telling you?”

Always remember two key things: What protection is there for you, and is the practice worth what the owner says it is worth?

1. Due diligence checklist
These are just some of the things that should be among the raft of documents – electronic and paper – that you are given by the seller. If not, ask to see them before making any decision. If they can’t or won’t provide them and have no legitimate reason for withholding this information, you should be on your guard.

• A breakdown of any staff salaries, remuneration, skills, career paths.
• A certificate of professional indemnity insurance.
• A copy of the reconciliation of the closing bank balance.
• A full client list, by year-end, industry, service provided and fee.
• A list of all clients lost in the last year and reasons why they left.
• Accounting fees billed for work – and any outstanding bills that clients have not paid. Compare payment date with the invoice date.
• All leasing information for the premises and equipment, and ask to see licensing for all software packages.
• Any claims pending or in progress against the firm.
• Any management letters on files.
• Any work in progress printouts for clients when the fee was generated and assess the size and complexity of the client and the financial statements.
• Book value and fair-market value of the furniture and fixtures, office equipment and other assets.
• Cashflow statement for the last financial year-end
• Comprehensive notes on file, such as review notes by the partner.
• Copies of the 10 to 12 of the top files by fee
• Information relation to any disturbing or material issues have arisen and what action has been taken.
• Logs of chargeable hours for staff with hourly charge out rates.
• Recommendations made by the last two practice inspection visits. Have these all recommendations been implemented?
• The financial statements - check for correct opening balances, rolled forward from the previous year; ensure all lead schedules tie into the numbers on the balance sheet and income statement.
• The firm’s top five high-risk audits.
• The income statement - 12 months to the last financial year-end.
• Third-party documentary evidence on the file that helps reach an audit opinion (such as responses to a circulation to receivables confirming amounts due at the cut-off date, copies of loan and/or leasing agreements and inventory lists and working papers, checking for reasonableness and completeness).
• Three or four special project files, such consolidations, cash-flow forecasts or estate planning files.
• Total draws for the year by partners.
• Up-to-date tax returns for the corporation and the individual owners and compare disclosed amounts on the return with the source document.

Source: ICAEW
3) Goodwill hunting
It is tempting to rake through the sale rail in shops in the hope of finding a bargain. But the reality is that one more often than not ends up buying something that is never worn, because ‘it was cheap’.

To prevent buying something just because it is cheap, consider the good will attached to the potential purchase. In many cases it is hard to put a price on the good will of a brand – and yet in most report and accounts from UK companies, from small enterprises registered at Companies House through to the multi-national blue chips, there will be an entry for ‘good will’ and its estimated value.

While clients and the value of the brand are fundamental considerations when valuing goodwill, you need to ascertain whether the figure set by the seller reflects reality.

As a rule of thumb, the valuation of goodwill should be based on the profits that the clients will generate, rather than any additional income they will produce, so the seller needs to convince you that you will be buying a profit-creating practice, rather than simply buying the prospect of any additional turnover.

Check the potential for up-selling and cross-selling services to clients, as well as the referral history. Look at the total time spent by the partners and estimated breakdown between client meetings, file review and working on the file – has generating goodwill come at a high service cost?

Also consider the retention rates – are they higher than average (the Institute of Chartered Accountants in England and Wales puts the average retention at 85 per cent)? If clients seem to disappear like bubbles in the rain, perhaps the goodwill is not as valuable as the seller would have you believe.

As an aside, once you have made your acquisition, build on the goodwill and brand perception. It is wise to ensure your own existing professional contacts are kept in the loop when buying, but also take time to build relationships with the contacts made by the previous practice owner.

It is clear that, with changes to the legal practice under the so-called ‘Tesco Law’ allowing high-street supermarkets to offer cheap solicitors’ services, and changes to the regulation of financial advisers, more cross-fertilisation will come in the way of strategic relationships between accountants, advisers and solicitors.

Consider how to ensure a smooth transfer of recurring revenue streams from financial advisers or legal firms. How will you service any centres of influence that are part of the new business? Finally, how are you going to manage communication between all these different parties?
4) Compliance conundrums and complicated calculations

An acquisition of a practice or book of clients/fees can be seen as a way for entrepreneurs to eliminate the risk of starting a firm from scratch. And, if you are buying from an experienced, retiring accountant, you may be forgiven for thinking that you can benefit solely from the fruit of his labours.

But even then there are potential business risks and compliance boxes to tick, details of which may not always be front-of-mind during a sale process but could cause headaches for a long while afterwards.

For example, if you have never done audit but are buying a firm that does, you may need to ensure that you or the appropriate staff members taking on this work can say yes to the following: you or they hold the audit qualification; you have applied to become a registered auditor; you have applied to nominate a responsible individual; and you and your firm complies with the Audit Regulations and Guidance.

If the firm you have just bought holds client money, but yours never did, you may need to check to see if your firm complies with the Clients’ Money Regulations and make any necessary adjustments.

Does the enlarged firm have appropriate levels of professional indemnity insurance (PII)?

Does the practice you bought have adequate and up-to-date PII that can run alongside yours for a certain period, or will you have to go back to your insurance provider and get a new quote covering the enlarged entity?

You might also consider a non-compete clause, which might apply more in the case that the seller is younger and could potentially return to public accounting, potentially enticing his old clients away from you – even though you paid for them fair and square.

Another thing to consider is how to calculate a fair and reasonable earn-out that benefits both the seller and the buyer, before anyone signs on that dotted line, as Box 2 explains. After all, ‘the labourer is worthy of his hire’ as the old proverb goes.

Source: ICAEW
5) A people profession
You should never underestimate the value of the human element when considering buying another accountancy practice. This value was highlighted at the 2011 Association of Chartered Certified Accountants conference, where its chief executive, Helen Brand, said: “At a time of continuing economic instability, the role of our members on the business stage is critical.

“I believe this is a time of great opportunity for the accountancy profession and we must work harder than ever to retain trust and show how we bring public value.”

Retaining trust and showing value to employees and clients is essential not only for your business plans but for your brand and future goodwill.

From the employee’s perspective, your own employees want to know whether they will have to take on additional workload with no hint of immediate or future remuneration.

The employees of the practice you have bought will want to know whether they have a role within your expanded firm, and if not, what will be the terms of their redundancy. Will you treat them as fairly, if not better, than their previous employer? The last thing you need is bad morale or, worse, potential public employment tribunals on your hands.

Then there is the client value. Obviously this can have a solid figure put on it in terms of recurring income, additional services for which you have billed, the cost of servicing Client A compared with Client B.

But when you have made every actuarial calculation to form a detailed picture of the pound-for-pound worth of every corporate or individual client, and can see how much revenue these will bring to your firm, there is a danger that – to paraphrase Number Six in The Prisoner – all you will see is the number, not the free man.

It is therefore important to know in advance how you will help the new clients cope with the transition from their old accountant to your firm. Many trade buyers will implement a set period of handover, where the retiring accountant from whom they have bought the firm will agree to work as a consultant to ensure a smooth transition.

In some cases, key clients may be introduced by the outgoing seller to the new buyer so that personal, face to face meetings help to build a relationship. Whatever your preference for integration and transition, you will underestimate the value of relationships between staff and clients at your peril.
You’ve probably heard the clichéd expression about how buying a firm is like a marriage but regardless of the cringe factor associated with such verbal imagery, there is truth to the saying. Just as there are many different types of sellers – retiring single-owner practitioners, joint owners of small family firms – so there are different types of buyer, each with his or her own vision of what they want to achieve in the years ahead. Some buyers are from long-standing small practices who want to expand; others may be mid-tier chartered firms that wish to acquire scale while others could be entrepreneurial men and women of experience who have always dreamed of owning their own practice. Whatever camp you fall into, make sure that the firm you acquire helps you to achieve the vision you have for your own business. Make sure you get the right price, have asked the right questions, get the right people on board and do the right thing by client and colleague. The road to buying an accountancy firm is never smooth, so hopefully this guide will have pointed out the key pitfalls into which the unwary have fallen, so that your path to success is far less dangerous.

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Stephen Hagues, father of three and keen businessman, believes trust is the core element of any relationship – personal and professional.

He qualified in business management, then became a chartered marketer before spending a decade growing his clients’ IFA businesses, directly acquiring key personnel from competitors across the North of England.


Stephen has a deep understanding of both executive search and the UK regulated market and its people.

He says: “I believe trust is hard earned and easily lost in a service industry, so I ensure all of my firms operate with integrity to the best principles and consist of highly trained staff.”