

The Practicing

CPA

THE NEWSLETTER OF THE AICPA PRIVATE COMPANIES PRACTICE SECTION



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Inside

Guiding new staff to develop the practice contributes to staff retention. Some practical steps for providing this guidance is offered by a consultant who specializes in helping professional firms develop rainmakers.

Now that the holidays are coming up, it's a good idea to brush up on which employee gifts are taxable and which are not.

Need to determine reasonable compensation? Here's a list of the best compensation databases.

PCPS Update

The November Practice Management Forum: Implementing value pricing. Look for the MAP Survey results. What do your top talent really want? TIC Update

November 2006

Consolidation Caveats

Based on the demographics of the accounting industry, it's commonly assumed that a sizable number of CPA firms genuinely need to merge or sell. Many firms, specifically those with aging principals or ambitious growth plans, even say they want to do so. The characteristic firms that should be or could be merging or selling at this point include:

- Aging firms without successors
- Small or midsized firms with mergers or acquisitions as part of their growth strategy
- Firms with strong specializations looking to provide a fuller range of services
- Firms with other significant challenges, such as recruiting and retention or a need to invest in technology

Nevertheless, many firm owners fail to overcome obstacles that are either held unconsciously or exist only in the past. These may include a reluctance to give up or share control of the firm, or uncertainty about and an unwillingness to commit to an unknown future. A standard excuse is, "But look at what happened in the late 1990s." However, comparing current market forces with those in play almost a decade ago should at least reassure owners enough to allow them to take the next step, which is to address the specific underlying fears that prevent them from fully investigating their mergers and acquisitions (M&A) options. Such an analysis confronts the difficulties involved in CPA firm mergers, but also enables the development of practical solutions. We are in a very

different market today and, in reality, the M&A boom of the late 1990s should be the source of numerous lessons rather than a deterrent.

Moreover, all the successes and failures of the past—whether back in the 1990s or more recently—should serve as learning opportunities.

For many firms of the right ages and sizes, mergers or sales are now an effective way to maintain growth and ensure the future. Firm owners who don't have a successor or whose founders are one to seven years from retirement, or who see the potential for long-term growth through a sale or merger, should examine whether they are currently happy with:

- The work they are doing
- Their work/home balance
- Their earnings
- The future prospects of their practice
- Their firm's recruitment and retention efforts
- Their firm's technology infrastructure

A no answer to one or more of the above means it is time to investigate and plan accordingly.

Although the most common thinking is still "bigger is better," strategic mergers are the order of the day, and the demographics of the current marketplace are such that over the next several years, more and more firms will need to sell or merge. Valuations will go down as supply increases and buyers become increasingly discerning. This will lead to pricing pressure and lower payouts for a merger or sale. For many accounting firm owners, now is the right time to start actively considering long-term options

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by learning from the past, understanding the marketplace of today, and starting the process of ensuring firm success in the future.

Make time to investigate

Owners who said they “don’t have time” to investigate their strategic options may need to take a closer look at their priorities, especially if their firms could benefit from a sale or merger. The excuse of “no-time” is usually a smokescreen rooted in the fear of the unknown. This is the entire business we’re talking about; given the stakes, surely the time can be found somehow.

If you’re staying, negotiate control

For a firm owner on the verge of retirement, control may not be a major issue. But if an owner is looking at ways to take his business to the next level without stepping aside, the issue of control can bring potential mergers to a halt. The specter of the 1990s acquisitions rears its head and seems to tell us that an owner who cedes control is risking the future of the firm and everything he or she has worked to create. But history can teach a different lesson here, namely, that during the sale or merger process, everything can be negotiated.

Effective negotiation during a merger or purchase can allow firm owners to better manage control issues and set the time frame of the transition process. Perhaps the acquired firm initially operates as a “division of” the firm. Perhaps the owner retains certain management duties for the first two years. However the control issue is addressed, the mistakes observed in the past can be avoided by the right acquirer, who will make it a priority that existing management not be marginalized.

Don’t underestimate the need for the “right fit”

M&As sometimes fail because the parties involved don’t ensure that the consolidation will be the “right fit.” Contrary to perceptions from the outside, each accounting firm is unique. Determining which firm is a good match for you and your staff is a big but not impossible job. Take the time to analyze your business. Keep senior staff informed, and be sure to ask the right questions: What specific industries or niche services set your firm apart? What roles would be either preferable

or at least acceptable to you and your key employees, in the event of a merger?

Success in finding the right fit lies in planning, preparation, and motivation. Devote as much time to the process as you would allocate to any significant project. After all, there can be a significant return on investment, especially if the process is handled properly. Since it can be difficult for management to be objective about its own firm, the services of an expert consultant can be invaluable.

Know the market value of your firm

Did firms overpay for small practices in the late 1990s? Many say *yes*, and that has made many traditional acquirers hesitant. Before embarking on any sale or merger, the same due diligence that a firm applies to its business valuation clients needs to be turned inward. Doing one’s homework is essential.

Some firms find that there is more value in not selling, given the particulars of a marketplace. However, some aging owners mistakenly believe they can make more money if they let their practices self-liquidate. This approach is more likely to cause a mass exodus of talent and clients, resulting in a loss of both current income and overall firm value. But even for younger CPA owners, determining the path to a larger long-term financial payoff is an important undertaking. Once again, negotiation is key because both buyer and seller need to agree to terms that allow them to make more money together than they would apart.

Address the fear of change

Fear of disrupting the status quo is the biggest single obstacle to M&As in the accounting industry. Fear, whether rational or not, is the enemy of the firm owner. To think objectively about the situation, it can be helpful to speak with other accounting professionals and firm owners, such as CPAs who have successfully sold or merged their practices. It can be helpful, too, to speak with CPAs whose sales or mergers have failed.

Also, solicit input from your closest advisors and speak with an industry consultant who can provide an unbiased, third-party opinion. Getting past one’s fear is the first step to uncovering potentially lucrative opportunities.

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TIC Update

PCPS members may already be aware of the work of the PCPS Technical Issues Committee (TIC), a group that monitors and comments on emerging standards from the small firm and small company perspective. As an update on its ongoing activities, TIC recently conducted liaison meetings with both the Financial Accounting Standards Board and the Governmental Accounting Standards Board, offering recommendations for

changes in proposed standards and reporting on existing or potential implementation problems faced by small practitioners and their clients. These annual liaisons with both boards offer TIC the chance to enlighten standard setters about practical and theoretical problems with new and established guidance.

TIC comments on proposals from a wide range of standard setters, including the AICPA Professional Ethics Executive Committee, Auditing Standards Board, and Accounting and Review Services Committee. In

fact, during 2006, TIC expects to issue roughly 15 comment letters to these and other bodies. Proposed standards often are simplified or clarified as a result of TIC's efforts. In addition, among their other activities, TIC members regularly serve as presenters at the AICPA National Advanced Accounting and Auditing Technical Symposium, as they did at July's conference in Chicago.

To learn more about TIC, go to <http://pcps.aicpa.org/Resources/Technical+Issues+Committee+and+Communications/>.

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After the papers are signed

A major cause of failed consolidations is the lack of post-closing efforts. Many firms fail to undertake effective marketing and public relations efforts following rebranding. Others fail to assuage the concerns of clients by keeping them informed. Still others do a poor job of keeping their employees informed

about changes in structure and culture. After a merger or sale, these mistakes can be catastrophic. Learn from the past, and keep lines of communication open long after the deal is completed.

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