Succession planning pathways for CPA public practitioners

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About the author

CPA Australia commissioned Hayes Knight, led by Senior Partner Greg Hayes, to supply the content of this succession planning pathways guide. Hayes Knight was selected on the basis of their broad experience and knowledge in the area of public practice succession. With over 20 years experience as a public practitioner, Greg's focus is on business consulting and taxation. He specialises in strategic planning techniques and is well known in the areas of practice management and business development, having been an active commentator in this area for over 15 years.

Support & Guidance

CPA Australia has a range of services specially tailored to support public practitioners. Should you require any further guidance please visit **cpaaustralia.com.au/practicemanagement** or contact your local office on **1300 737 373**.

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Contents

1 Succession and the accounting profession 1

2 Getting succession ready: managing the succession roadblocks 2

What the market expects – know the benchmarks 2

Profitability 2

Driving your practice as a business — the revenue line 3

Diagnostic checklist to assess your profitability performance 5

Profit strategies checklist to address under-performance 6

Profit improvement working paper 7

Liquidity 8

Diagnostic checklist to assess your liquidity performance 8

Liquidity strategies checklist to address under-performance 9

Credit policy 9

Communicate the policy 10

Implement the policy 10

Liquidity improvement working paper 11

Growth 12

Planning for growth 12

What sort of growth? 12

Growth through increased clients 12

Growth through increased fees per client 13

Pitfalls of growing too quickly 13

Growing your practice 14

Diagnostic checklist to assess your performance 14

Growth strategies checklist to address under-performance 15

Growth improvement working paper 16

Client mix 17

Diagnostic checklist to assess your performance 18

Strategies checklist to address under-performance 19

Client mix improvement working paper 20

Service range 21

Diagnostic checklist to assess your performance 22

Strategies checklist to address under-performance 22

Service range improvement working paper 23

Practice maturity 24

Maturity improvement working paper 25

Staffing 26

Who makes up the staff mix? 26

So what's the answer? 27

Contents

Diagnostic checklist to assess your performance	28
Strategies checklist to address under-performance	28
Staffing improvement working paper	29
Leverage	30
Diagnostic checklist to assess your performance	31
Strategies checklist to address under-performance	32
Leverage improvement working paper	33
Systems and procedures	34
Diagnostic checklist to assess your performance	35
Strategies checklist to address under-performance	35
Systems and procedures improvement working paper	36
Write-off levels	37
Diagnostic checklist to assess your performance	38
Strategies checklist to address under-performance	38
Write-off level improvement working paper	39
3 Selecting your succession option	**40**
Sale of practice	40
Checklist of typical buyers	40
Sale of practice checklist	41
Sale of a fee parcel	42
Checklist of typical buyers	42
Sale of a fee parcel checklist	43
Progressive sell down	44
Checklist of typical buyers	44
Progressive sell down issues checklist	45
Merger	46
Checklist of typical merger partners	46
Merger issues checklist	47
Internal succession	49
Checklist of typical internal succession candidates	49
Internal succession issues checklist	50
Admission of a new partner	51
Checklist of typical partner candidates	51
Admission of a new partner issues checklist	52
Buyout by existing partners	53
Buyout issues checklist	54
4 Valuation and pricing	**56**
Why value and price may be different	56
Current practice valuation methodologies	56

Contents

Capitalisation of future maintainable earnings 56
Procedure for valuation under capitalisation of future maintainable earnings 57
Establishing the maintainable earnings 57
Capitalisation rate 58
Calculating the value 59
Rule of thumb or industry multiplier method 60
Other methods - return on investment (ROI) 60
Valuation segmentation 61
Flowchart to selecting a valuation model 62
Valuation template working paper 63
Working paper to assess price against valuation 65
Checklist of pricing considerations 66
Pricing goodwill, plant & equipment and working capital 66
5 Implementation and timing **67**
Your succession plan checklist 67
Issues to consider in going to the market 70
Timing 70
Contracts and agreements 70
Warranties and indemnities 71
Non-compete expectations 72
Financing considerations 72
Marketing options 73
Utilising a broker 73
Acting for yourself 74
Using an intermediary 74
Flowchart to selecting your marketing approach 75
Information memorandum 76
Information memorandum elements 76
Information memorandum checklist 78
Timeline and milestone events 79
6 Exit considerations **80**
Compliance issues 80
Staff transition 82
Client advice 82
7 Additional succession planning support **84**

1. Succession and the accounting profession

Who will buy my practice?

This is a question that is increasingly being asked by practitioners around the country. With the average age of public practitioners now well over 50, an increasing number are contemplating how they will succession manage their practice. For many the focus is on the capital value of the practice and how they can extract this capital value to assist in their retirement planning. Succession though, isn't always about retirement. There are a whole range of events that can be a catalyst to the sale of a practice.

The demographics of public practice in Australia paints the picture. Currently, there are just under 11,800 public practice units, and of these 89 per cent are represented by sole practitioners and two-partner firms. Add to this the ageing of the profession and you have a large number of small practice units delivering similar services to a similar client base. These firms are typical of small business in Australia. CPA Australia public practice statistics identify that approximately 42 per cent of members may have a succession event for their practice within the next five years.

So, where does this place public practitioners looking to plan and implement their succession?

Your options are wide but limited. The main options are:

- sale of a fee parcel
- outright sale of the firm
- merger
- sale to existing partners
- internal succession
- introduction of new partners
- orderly winding up.

Each of these options, with the exception of the last one, will seek to generate a return of working capital and also a return on your investment in plant and goodwill. The critical factors will be timing, pricing and planning. Your approach to the sale of your firm will vary depending on which sale option you are planning to pursue.

The difference between taking a structured approach to this and a last minute rush to find a buyer can be many thousands of dollars. Planning the sale of your practice is about maximising the value of your asset and also managing an orderly transfer of your professional obligations in respect of your clients and your team.

Given the expectation of an increasing number of firms and fee parcels coming on to the market, without question we will see buyers gravitate toward value. A clear message is that we should all be planning for the ultimate sale of our firm – irrespective of whether we expect to be in practice for two or 22 years. Every firm should be developed with view to the ongoing succession and ultimate sale of the business. The great thing about doing this is that you build a strong and profitable business from day one. And when the time comes for you to move on, then you have an asset that is attractive in the market and one for which there should be strong demand.

This succession guide has been designed to provide you with some of the practical tools that will assist you in planning and managing your succession. It is particularly focused on small and medium size practices, although the fundamentals hold true for all.

2. Getting succession ready: managing the succession roadblocks

It is important to prepare your practice for succession. The better your preparation the better the outcome you should achieve and the smoother the transition. Preparing your practice for succession may take several years, so the planning phase is quite important. Planned succession will always outperform succession as an event. If you do little planning and simply put your practice on to the market then it is likely that you will achieve a lesser outcome than may have been possible.

The main reason why your succession preparation may take several years is to allow sufficient time to enhance the performance and appearance of your practice. One of your objectives with your succession planning is to maximise the financial outcome in the succession. Over time there will be an increase in the number of practices and fee parcels coming on to the market. This being the case, buyers will gravitate to the better quality practices and better pricing will be achieved by the practices who are meeting the performance expectations of the market. It is important to know what those performance expectations are and then to be able to groom your practice as much as possible to meet these expectations. Once you have your numbers right, then you need time – time to prove that the numbers are established and sustainable, rather than a one year aberration. In most cases a buyer will want to look at performance figures for not less than three years. The better the picture you can paint, the better the outcome you will achieve.

Under-performance in key areas of your practice causes succession roadblocks.

These will be the areas a buyer looks at closely to decide whether or not your practice is right for them. Increasingly the market is being educated on what to look for. The public practice business model is a relatively simple one. This does not mean being in public practice is easy but the things that differentiate a strong practice from a weaker one are reasonably easy to identify and measure. This means that buyers will be looking for key characteristics in a practice. Much of this revolves around the areas of profitability, liquidity, efficiency and growth. Key influencers of this will be the quality of your client base, the strength of your systems and procedures, the quality of your staff and the depth and breadth of your service range.

Get these areas right and not only are you in a strong position to negotiate your price, but equally importantly you have removed some of the roadblocks that could otherwise exist in a buying decision.

Most practices have areas of under-performance. In some cases you may be working to improve these, in other cases you simply accept them as being tolerable. Getting succession ready is about understanding market expectations and then as much as possible positioning your practice so that it rates well in the key areas.

What the market expects – know the benchmarks

Key to removing any performance roadblocks is to know what the market expects. There have been a reasonable number of benchmarking studies undertaken on the accounting profession. Much of this information is public knowledge or easily accessed with a little research. Given the level of fragmentation in the accounting profession you should be aiming to be well above the average. There is a marked difference in the performance of top quartile firms and the rest. If you are looking to benchmark your performance, always measure against the top quartile. As the number of firms experiencing succession events increases, performance will separate those that are the most attractive opportunities in the market.

The rest of this section is devoted to describing the key areas that your practice will assessed on, the benchmarks that currently exist and which tend separate the better performers.

Profitability

Ask any accountant how they are and you'll generally receive a response that says something about them 'being busy'…but is this busyness profitable?

Time is our most limited resource and all of us share the desire to be using our time profitably. However, sometimes we and get so involved in trying to keep up with client demands that we end up either:

- accepting work we don't have the capacity for
- doing types of work we shouldn't
- always rushing to meet deadlines and being inefficient in doing so
- not charging enough for our time.

Most of us offer the public a variety of services of differing profitability. Do you know your most profitable type of work and what your ideal mix is?

The impact of poor profitability should be frightening enough to spur us all into taking immediate action to ensure it doesn't happen to us. Poor profitability will eventually negatively impact everything about your practice. You end up in a downward spiral where things just seem to get worse. Partners and staff often approach the problem by trying to spend even more time at work doing more of the same work which may be only compounding the problem…*The floggings will continue until morale improves!* Funds for new technology and other resources that may assist are limited. Partner, staff morale and motivation suffer, people get sick or leave. Not a pretty scenario.

As accountants we are very good at quickly determining whether our client's businesses are profitable. However, like many other types of professions some accountants are surprisingly tardy in analysing and keeping on top of their own practice profitability. The golden rule to improving your profitability is that first you must know what your current profitability level is and what drives it. To quote a well known saying in our profession: *if you can't measure it, you can't manage it.*

Driving your practice as a business — the revenue line

Focusing on the business of accounting should never be in conflict with your profession as an accountant. Building a successful business is an essential ingredient to a public practice. At the same time we recognise that the business focus can be a challenge for a practitioner who is highly focused on client issues. There is a tension between the outworking of your profession, client management and business self-interest. Get the balance right though (and it is possible) and you have a recipe for success.

Let's explore the business development of an accounting practice and take a focus on the revenue line.

Firstly, why the revenue line?

There are a number of fundamental reasons. Certainly it is a natural place to start and one that has an interest for most of us. Beyond that, however, there is a more compelling reason. And that is for most practices, if they are struggling to achieve bottom line performance, it is because of under-performance at the revenue line. Most accountants tend to get their costs right, although at times we are 'tighter' than we should be from a business perspective. Many firms fail, however, to get the revenue balance right.

The majority of firms today still operate from a time/cost basis. It has been drilled into us from years past and we are all about hours spent, hours charged. Some firms have broken this shackle and moved to concepts of value billing, premium fees or other models; however, they are very much in the minority. And often, where it is adopted, it may only be for a part of their work. As a consequence our revenue results are often driven out of productive capacity (read number of people times their available hours), the charge rates applied, and our workflow efficiency level (read productivity of individuals against available chargeable hours). Mathematically simple, but it gives you a headache working through all of the permutations.

Then if we don't get it right we go through the introspection of analysis around workflow management, productivity levels, staff mix, staff skills, write-off levels, client mix, and so on. The list goes on and on. Now it is possible to get it right. However, it is a constant vigil and it will often take your focus away from the bigger picture and the bigger opportunity – managing client relationships and being available to take on work opportunities that occur.

In looking at various models within accounting practices all over the country and beyond I can come up with some reasonable observations regarding the revenue issue for accounting firms. Before I do, let me say that there is no one perfect model. So I'm not about to give you the prescription for success. There is a wide range of variables across practices and client bases.

1. **Compliance services delivered on a time cost basis will always create a limiting factor** – this is a simple reality for small/medium accounting firms. Basic compliance services are becoming a commodity and there will be continuing downward pressure on price in this area. If this is the extent of your offering then you will be under ongoing price pressure. Add to this price pressure the challenge of managing workflow throughout the year, staff efficiency on jobs, and simply the unexpected. In this environment, the chances of getting your revenue line right is under enormous pressure. Basic compliance services will always be a part of the majority of firms – the issue is, is it the only part?

2. **The ability to deliver some specialist services** – irrespective of whether you are a small or large firm there should be scope to deliver some level of specialist service. Being solely a GP practice means no premium in pricing and you are reduced then to playing the numbers game. Take a look at GPs in the medical profession. The only ones who achieve a really healthy return are those with a very high patient throughput. By adding at least one specialist area you open the scope to achieve some revenue premium and specialisations aren't all that hard to develop. The opportunities are almost limitless: CGT, GST, valuations, estate planning, succession planning, due diligence work… the list goes on and on. Even in a sole practitioner situation there is opportunity to do some of this. Look particularly at succession planning and estate planning. The baby boomer generational bubble that is flowing through will create enormous opportunities over the next ten years. When you do, make sure that you price it correctly. This doesn't get you away from the time/cost framework. It simply puts a better return rate in place.
3. **Consider passive income stream opportunities** – when you work on a time/cost basis you will only be paid for the hours you work. Add to this a passive income stream and you open up enormous possibilities. Financial planning, risk protection and mortgage facilitation are all services that your clients need. In one area or another over half of the profession already provides these services to their clients. Go back and have a look at the survey report in these areas. Generally these areas have the potential to create passive revenue streams. And, the real key is that these are services your clients need and if you were able to provide them in a responsible way then it is likely that they would prefer to buy from you rather than establish another relationship. It is a very practical value add and a way of enhancing the client relationship. Clearly disclosure and management of process are important here. This is an area that is in eye of the regulators at the moment. The Government's response to the Cooper report and the Ripoll report is likely to cause major changes in this area. Subject to these changes, financial services delivered professionally and competently by accountants creates a genuine win/win situation.
4. **Productise some of your services** – a number of firms have moved into broader areas of service delivery to their clients. This includes areas such as IT, human resources, accounts receivable management and data processing. Where these can be put into a product format so that the client is buying a 'package' rather than simply time, there is an opportunity to create some revenue leverage. Which products are right for you will depend to some extent on your client base and your areas of expertise or interest.
5. **Look closely at your charge rate** – most practitioners tend to undercharge rather than overcharge. In talking to practitioners all over the country, the most common theme that comes through is as follows: 'I'm always busy, always under work pressure, can't get enough of the right staff and have difficulty in keeping up with everything that has to be done'. You can actually feel the stress and tension. Sound familiar? Then, they go and send out their next account, agonising over whether they have charged the client too much. If you are looking to reduce your stress levels and win back some of the time that seems to get consumed in your practice, then start to increase your charge rates. Be prepared to lose some business – particularly the unprofitable, the slow payers and the problem clients. They don't add to your business. They simply cause frustrations.

   Also look at how you set your charge rates. Historically, the profession has set their charge rates either on a cost driven model i.e. a multiple of direct labour cost or they have attempted to model the market. Both of these methods can work but they also have their limitations. Be prepared to look at value billing and premium pricing models. It is an interesting fact that the majority of firms who score in the top quartile of benchmark studies employ one of these methods for at least a part of their work.

So, there are the top five ways to improve your revenue line. Have a think about and then if you need to, do something. Change always needs to be planned and implemented carefully. You might be surprised with what you can achieve. Ask yourself the question: If you could achieve a 10 per cent increase in your revenue line without any increase in your cost structure what would that mean to your business, your bank account and your lifestyle? In the vast majority of cases 10 per cent should be readily achievable. Worth thinking about, isn't it?

A more recent area that has emerged in the succession of accounting firms is the question being asked – what does it take to generate the profitability of the firm. The number of hours worked by principals and partners varies significantly. Increasingly, the market expects that the firm can deliver reasonable performance results with the partners working not more than 40-50 hours per week. Whilst in some firms it may be common for the partners to work longer hours this should not be a requirement to achieve benchmark performance.

Diagnostic checklist to assess your profitability performance

Measurement	Method of calculation	Benchmark objective	Your result
Revenue per FTE	Gross fees divided by number of full-time equivalent personnel, including partners.	Aim for > $120k.	
Profit after partner salary %	Net operating profit after partner salaries, divided by gross fees.	A profit return of 20% on gross revenues is achievable. Where profitability falls below 10% you are likely to have trouble funding growth or	
Revenue efficiency	Measurement of time charged against budget. For staff with no admin responsibilities you should be looking for a 75-80% efficiency rate on a standard week. The efficiency rate will	Can be measured on a firm productivity basis, based on the budget you have created. All employees should have productivity budgets.	
Key costs to revenue %	Labour cost (including allowance for principal or partners salary) to gross revenue.	50-58% 22-28%	
Average fee per client	Gross fees divided by total number of client groups.	Will vary depending on your market segment. An average below $1000 will place pressures on you. Ideal position > $3k.	
Average fee per tax return	Gross fees divided by number of tax returns lodged.	Again will vary based on the practice and work type being undertaken. The objective is to drive the average number upwards.	
Fee structure partner down	Should be calculated on a partner down basis, using the partner rate as a benchmark from which to calculate a charge rate for other employees.	Will vary based on location, market segment and type of work undertaken. As a guide a manager could be 80% of the partner rate and a senior 60%.	
Hours worked by principals and partners	Average working hours required of principals per week.	Average hours within 40-50 hours per week.	

Profit strategies checklist to address under-performance

Much of the focus here needs to be at the revenue line or improving practice efficiency. Most accounting practices do not have issues with excess operating costs. Cost control is normally in place. It is more likely that profit is being influenced by a lack of revenue or workflow management efficiency. The following list represents the key strategies most likely to increase practice profitability. In a number of cases there is a range of ways to implement these strategies.

Strategy	Expected impact	Timeframe for effect	Other impacts
1. Increase charge rates and review charge rate setting model	Increase should flow straight through to bottom line.	Immediate.	May cause some resistance from fee-sensitive clients.
2. Cross sell more services within your client base.	Should increase average revenue per client, with profit return reasonably constant.	Normally 3-6 months to see flow-through effect.	Will require more resources and an active sales process.
3. Introduce new premium services e.g. financial planning, succession planning.	Existing client base should provide your initial market. May also attract some new clients. Should increase revenue with higher profit margin from the premium service.	Normally 6-12 months to see flow-through effect.	Will require additional skill sets, more resources and an active sales process.
4. Reduce write off levels.	Will increase your revenue capacity, either allowing you to take on more work or to complete the same amount of work with fewer people.	Immediate impact on capacity. Will normally take 3-6 months to realise flow-through results.	Should reduce workflow frustration and improve overall practice morale.
5. Acquire new target clients.	Your target clients should be the most profitable for your practice. New target clients should enhance your client mix and increase practice profitability.	Normally within 3 months of new client acquisition.	Target clients tend to buy more services and provide more interesting work.
6. Refine your client base.	Getting rid of problem clients will improve overall practice efficiency and open up capacity to take on new client or do more for your better clients.	Normally 6-12 months to see flow-through effect.	Will reduce frustration levels within the practice that are caused by problem clients.
7. Increase the marketing focus of your practice. Professionals need to sell.	A stronger focus on marketing will produce more work, leading to increased revenues and profits.	Normally within 3 months.	May require some marketing budget. Will increase the energy of the practice.

Profit improvement working paper

Objective	e.g. (to improve net profit by 10%)
Timeframe to achieve objective	
Strategies to be employed	1. 2. 3. 4. 5. 6.
Milestone events to measure progress	1. 2. 3. 4. 5. 6.
Resources required	1. 2. 3. 4. 5. 6.
People responsible for implementation	
Outcomes achieved	1. 2. 3. 4.

Liquidity

Profitability is great in any business. But talk to any insolvency practitioner and they'll give you some tragic war stories of profitable businesses that fell over because they ran out of cash. So while it is essential for your long-term well being that your business remains at a good level of profitability, it is also critical that you are managing your short-term liquidity to ensure you can stay in business.

Your combined debtors and work in progress represent the 'lock up' of the firm. This is an area that the profession has focussed on over recent years. The better performing firms now manage their lock up in less than 80 days on average.

Get the work, do the work, bill the work and collect the money. Sounds simple doesn't it, but sometimes it just doesn't happen as easily as this.

Collecting fees is an area that many practices struggle with. Debtors can get out of control and industry benchmarks indicate that average debtors within the profession represent 60 to 90 days of annual fees. Not a good advertisement for the people who advise business.

Collecting the money is an area that some practices struggle with and it is due in part to the close relationship we have with our clients and the difficulty we have in asking for money from the client. At times, the client may also exploit this relationship and when funds are tight the accountant is one of the last to be paid. I don't think you would disagree if I suggest the accountant should be the first to be paid given our role as business (read trusted) adviser.

Introducing a credit policy immediately within your practice may be difficult and unpopular for a number of reasons. Firstly how do you approach your large clients who are unable to pay on your new credit terms, but who you cannot afford to lose as a client? Secondly, how do you transition your clients (who are accustomed to pay between 60 and 90 days) to meeting your new credit terms? We suggest the new credit policy be implemented in a staged process.

1. For those clients paying on 90-day terms, negotiate them back to 60 days.
2. For clients who have always paid 60 days, these should be brought back to 30 days.
3. Continue this staged process until all clients are paying within your new trading terms.
4. Communicate the credit policy to existing clients at every opportunity available. Mediums such as client newsletters, firm brochures and websites provide excellent opportunities. Where appropriate you may wish to update and reissue your engagement letter.

For new clients a credit policy is not difficult to introduce, as it will be explained in the engagement letter. Or, preferably, if you can outline your trading terms as early as possible, the initial meeting would be a great opportunity to do this. By setting clear expectations at the start you give yourself the very best opportunity to get client payment behaviour right from the beginning. It is always harder to change existing habits than to establish new ones.

Equally important is your management of work in progress. You should be managing your work so that it is billed progressively or on completion of work segments. Regular billing will drive down your work in progress and improve your liquidity position.

Diagnostic checklist to assess your liquidity performance

Measurement	Method of calculation	Benchmark objective	Your result
Liquidity debtors days	Debtors outstanding at month end divided by annual revenue, then multiplied by 365.	Average for the profession 60 days. You should be aiming for less than 45 days.	
Liquidity WIP days	Work in progress at month end divided by annual revenue, then multiplied by 365.	Again, average for the profession is 60 days. You should be aiming for less than 30 days.	

Liquidity strategies checklist to address under-performance

Improving practice liquidity normally comes through an integrated an approach. Whilst one strategy in isolation will have some effect, it is the implementation of a range of strategies that will produce optimal results. The following list represents the key strategies most likely to increase practice liquidity. In a number of cases there is a range of ways to implement these strategies.

Strategy	Expected impact	Timeframe for effect	Other impacts
1. Explain your payment terms in your engagement letter.	Establishes expectations with client from commencement.	Should flow on from initial billing period.	May require a follow up process to implement the payment terms required.
2. Quantify fees in advance.	Removes uncertainty and allows client to raise the fee issue in advance of work being undertaken.	Should reduce any delay in payment due to a query on the quantum of the bill.	A risk of write off if you under quote the job.
3. Bill regularly.	Progress billing will lower your WIP exposure and accelerate your cash cycle .	Should show within 90 days.	Requires up to date WIP information and discipline to bill work out on a monthly basis.
4. Bill as near as possible to the conclusion or work segments.	Allows client to relate the bill to the work completed.	Normally 30-60 days.	Standard procedure should be to bill work out at conclusion or agreed milestone events.
5. Where practical present the account to the client.	A percentage of clients will pay immediately.	Within 30 days.	Typically reduces debtor days by a minimum 15 days.
6. Provide payment alternatives e.g. credit card, EFT etc.	Greater flexibility in payment methods will accelerate payment cycle.	30-60 days.	Requires alternate payment facilities to be in place.
7. Consider fixed fees for some work.	Clients often relate better to packaged services for a set price. Normally tied to a regular monthly or quarterly payment.	30-60 days.	Need to develop skills in quoting on a package of services. Generally needs to be accompanied by a strong engagement letter.
8. Invoices should state payment terms and provide EFT details.	Will remind clients of payment terms and encourage EFT payment.	30-60 days.	EFT payment normally the lowest cost method of managing payments.
9. Follow up debts systematically and frequently.	Slow paying clients will pay faster when there is a systematic follow up process.	Within 90 days.	Will identify and reduce potential bad debts.
10. Consider the fee issue in your client selection criteria.	Some potential clients may be rejected on the basis of the payment risk.	Progressive.	Should result in a better quality client base.

Below are procedures to implement a credit policy within your practice.

Credit policy

The first step is to have a documented credit policy. The credit policy will include trading terms and a follow up procedure when payment has not been received within agreed trading terms. A simple rule is to have some form of follow up every seven days. If your trading terms are 14 days from end of month then the follow up procedure starts at 21 days after the end of the month. We suggest the following procedure:

1. **Send a letter** to all clients who have not paid within 21 days explaining terms of trade and asking for payment within seven days. Say that if there are any problems with the account they should contact the credit manager immediately.
2. If payment has not been received by the 28th day, the client should be **contacted by phone**. If the first letter failed to produce results, it is this call that will generate action. Make notes of what was agreed with the client.
3. From your phone call with the client, if payment was agreed within seven days and had not been received by the following week, then **a final letter** should be sent requesting immediate payment or the account will be sent to the debt collectors. This letter generally produces a result.
4. The final step of course is to **send the account to the debt collector** if there has been no response from the client. The partner responsible for the client is advised first in case there are reasons why the client should not be put in the hands of the debt collection agency. Our experience is that clients who reach this stage are those whom we don't want to retain and are likely to leave after the debt collector steps in.

Some tips to assist in the collection process:

Repayment plans - If the client on the phone says they are having a cash flow problem, then agree on a repayment plan. Ask for weekly payments until the debt is repaid over say a period of one to three months. Send a letter to the client confirming the arrangement and closely monitor payments.

What about finance? - Alternatively if the debt is relatively large (say over $10,000), the amount could be financed by financial institutions that specialise in this area of funding professional fees. You receive the funds up front and the client repays the debt over a period of no more than 10 months with interest and an administration charge. The downside to this arrangement is the accountant guarantees the repayment of the amount as no security is taken by the finance institution. This means if the client defaults, you take over repayment of the debt.

Fixed fees - Finally, setting up fixed fee arrangements with clients having agreed amounts automatically credited to your bank account every month improves cash flow and saves the administration time of collecting money. The key to fixed fee arrangements is to ensure that you have clear terms on what the agreed fee covers. Where you are not clear on this you run the risk that the client will expect all and every piece of work you complete for them during a year to be within the fixed fee agreement. Where you are using fixed fees, agree in writing the work that is covered. Be specific and state in the engagement letter that you will identify any work that is not covered under the fee agreement in advance of commencing it. Then make sure that you do.

Communicate the policy

A policy is not worth much if no one is aware of it. The policy should be communicated as follows:

- the engagement letter is an important document to communicate your trading terms as the client signs the letter agreeing to the terms.
- the trading terms should be clearly indicated on every invoice and statement sent to the client. Also be clear if the trading terms are from the invoice date or end of the month. Even better, state a date when the invoice is due and payable.
- don't forget your team. The people responsible for following up clients should be crystal clear on the credit policy. Similarly your professional team must understand the firm's credit policy. I would even ask the professional team to check if there are any amounts owing by the client greater than 30 days prior to commencing new work for that client. If the client is finding it difficult paying existing accounts, they are unlikely to afford any new work. Partner clearance is required in cases like this.
- the credit policy should be communicated to clients during all follow up letters and phone calls.

Implement the policy

This is the most difficult step. Hands up those who like collecting money! It is important to select the right people for the job. Your administration team will most likely do the follow up and reporting to the administration partner(s). The follow up and reporting must be weekly. The types of reports provided to the partner include:

- a debtors trial balance
- a schedule of clients who have received follow up phone calls and their response

- a schedule of clients who have been sent a second letter
- a schedule of clients who will be put in the hands of the debt collection agency
- total collections for the week and month compared to budget.

The important point here is to have weekly meetings of less than one hour to ensure the credit policy is being implemented.

The credit policy explained above should ensure your firm is the first to be paid by your clients. Alternatively those clients who have a problem with paying for your services within agreed trading terms are likely to leave. A good result either way!

Liquidity improvement working paper

Objective	e.g. (to reduce average debtor days to 45 days)
Timeframe to achieve objective	
Strategies to be employed	1. 2. 3. 4. 5. 6.
Milestone events to measure progress	1. 2. 3. 4. 5. 6.
Resources required	1. 2. 3. 4. 5. 6.
People responsible for implementation	
Outcomes achieved	1. 2. 3. 4.

Growth

If you are not growing, then you'll be going backwards. All accountancy practices need new work, if only to replace old work that may be declining for very good reasons. Also, the market expects to see revenue growth. As a guide growth should be not less than 10% per annum. This should be a mix of both price growth and real growth. But all growth is not good – especially unplanned, unexpected or haphazard growth. This type of growth can impose severe strains and pressures on a practice resulting in:

- reduced servicing of existing clients
- greater risk exposure from poor quality work
- potentially damaging your firm's reputation and negatively affecting your referral streams
- overloading yourself and staff members resulting in reduced performance or, at worst, resignations
- greatly reduced efficiency and hence profitability
- increased strain on liquidity.

Like profitability, we need to know the numbers before we can hope to manage and improve them. Hence we need some simple and effective systems to record and monitor our growth. We also need to plan for growth setting targets for what type and how much growth we want and how we intend to achieve this.

Different practices will need differing levels of growth at different stages in their life. In a stable practice only minimal growth may be needed. However a practice with succession issues and looking to bring in younger owners to pay out the older exiting owners may have fairly high growth demands.

Long-term sustainable growth requires comprehensive planning, good systems and importantly focus and persistence by the principals of the practice.

Planning for growth

When you are planning the future growth of your practice you must remain pragmatic. Rush into business growth and you risk damaging your existing client base, reputation, and most of all your bottom line.

So what elements should you be thinking about when planning for next year's growth and what are some common pitfalls of practices that grow too quickly?

What sort of growth?

The first issue you need to consider is which path of growth would best suit your firm and will most efficiently lead you to the outcome you wish to achieve. Will you seek expansion through attracting more clients to your firm or through encouraging a greater level of fees from your existing clients?

You could, of course, decide to do both but each will require a different strategy.

Growth through increased clients

This must be a targeted approach and not just growth for growth's sake. Lots of people talk about client targeting, but few do it well.

Most importantly, you must sit down and identify your target client. Be specific. Are you looking to work with small businesses or is your practice wishing to expand into the larger end of town. Where are your ideal clients located? Are they in the same suburb as you or are they geographically diverse?

Specialisation might be the stream of growth for you. You might have built up considerable experience dealing with businesses in a particular sector and expanding further into this industry might be the most effective way to go. Alternatively, you might be experiencing a drop off in your industry of specialisation and may decide to market further afield.

In implementing a growth strategy, you should look closely at the external promotion of your firm. Are you going to take a shotgun approach or are you going to tackle it in a targeted way?

Perhaps the most simple, but most forgotten technique, is to utilise your existing networks. Talk with your existing clients. Referrals are one of the most simple and effective ways to grow your client base.

Client seminars are also a great low-cost way to showcase your firm and the services you offer. In order to achieve the best results in attracting new business, your audience should be made up of a mix of clients and non-clients.

Growth through increased fees per client

The first step with this growth strategy is to compare what services you are currently providing with what services your clients are actually using.

It might be that the particular services you are offering are no longer suitable for your target group. You might decide to expand a well-utilised area of your business, offering your clients additional value-added service. You might also decide to increase your service offerings, adding to your compliance capabilities with business consulting, financial planning or IT support.

Alternatively, your growth might be stunted by ignorance. Your existing clients might simply not be aware of all the services you offer. Make sure you continue to educate your clients along their own growth cycle as to the range of expertise and service you can provide. The simplest way to do this is to have an Area of Operation document detailing the services provided by your firm. Every accountant in your office should have a copy of this document and it should be standard procedure to walk your new clients through your service range.

Increasing your fees per client should also include a reasonable level of price growth. Don't get stuck in the rut of maintaining the same charges year in, year out. Your costs are increasing, so to should your prices. Where your fees are correctly set, then annual price growth of 3-4% will only keep pace with inflation.

Pitfalls of growing too quickly

So you have decided how you are going to grow your practice but before you rush into things there are a few issues you must consider.

- **Do you have the capacity to grow?**
  Having identified your target client, it is important to determine whether you have the capacity to care for them. You don't want to find yourself in the situation where new clients are walking in the front door and existing clients are heading out, just as fast, through the back door.

  This capacity has to be at the partner level. It is typically the most senior people who are the busiest in an accounting practice. These are the people who are under the pressure, often work the longest hours and sometimes simply don't have the time to do all the things they would like to do, let alone those that they should be doing. If this is the case in your firm, how can you expect to attract and service new clients? The key is to create capacity at the top level. You might decide to have at least one full time equivalent in excess of current requirements to allow sufficient time for managing client relationships. You should not waste this additional capacity, but make use of it by driving the work vertically down your firm.

- **Ensure quality control**
  Make sure you don't get too busy too quickly. You must have systems in place to ensure the growth process is as smooth as possible. Make sure your procedures and working papers are in order. With growth comes a greater need for delegation and a heightened importance on systemised operation.

- **Can you afford to grow?**
  Do you have sufficient working capital to match your desired growth? Most practices can cope with growth from a profitability point of view, but many have problems in the liquidity area. Have you considered the time lag between taking on additional work and actually seeing the money in your bank account? Fees can be tied up for up to four months so your capital must be flexible enough to allow for this delay. You should also consider additional costs associated with staff increases and marketing efforts.

- **Avoid discounting**
  Perhaps the most ineffective growth strategy comes with offering discounted fees. Discounting for professional service is a lazy marketing strategy and one that is sure to come back and bite you. You may find yourself in a spiralling price war that you cannot afford to sustain. The client who comes to you on the basis of a discounted fee will leave you for the very same reason.

- **Don't forget your existing clients**
  It is important to ensure you have systems in place that allow you to keep in touch with existing clients. You might be working towards targeting a different end of the market, but you cannot afford to alienate existing clients in the short term. Keeping in contact might be as simple as distribution of a regular newsletter or a phone call.

Growing your practice

Implementing an effective growth strategy is now more important than ever before. Our baby boomers are middle-aged and with a typical practice's clients being plus or minus ten years in age of the practitioner, more and more clients will be approaching retirement or exit stage.

This fact can have a major impact on the ongoing value of your practice when looking at your succession planning or exiting of older partners. Hence targeting your growth efforts at the appropriate client age levels can be beneficial to the value of your practice.

If you do not target your growth strategy well enough you risk filling up your client base with poor quality clients – those that cannot afford to pay, stress cases and those that are simply a drain on your resources.

It is crucial to understand the source of your desired growth. You must match your practice's needs with where you want your clients to come from. Don't let your firm get into the position where they take on anyone. Ensure you have a clear definition of your target client and you will have a greater chance of avoiding inefficient management.

There is no definitive answer to practice growth. Time spent examining your practice's structure and projected goals are the only way to go. Make sure you have a strategic plan in place that is supported by a clear marketing plan.

Diagnostic checklist to assess your performance

Measurement	Method of calculation	Benchmark objective	Your result
12-month moving average on fees	Immediate past 12-months gross fees divided by 12 and updated on a monthly basis to create a trend line.	There is no absolute benchmark for this. The trend line should be consistent with your growth strategy. Generally your growth trend should be in excess of 10% per annum.	
Client turnover rate	Number of client attrition's divided by average client numbers for the year.	There is no absolute benchmark here as it will depend on your strategic plan. Normally you would look for an attrition rate < 3%.	
Client addition rate	Number of client additions divided by average client numbers for the year.	Again, no absolute benchmark here. It will depend on your growth strategy and the basis for that growth. Results should be consistent with your plan.	

Growth strategies checklist to address under-performance

Growth strategies can generally be separated between internal and external growth strategies. Most firms need to have a mix of internal and external strategies. You need to be developing new clients, but also maximising the value delivered to, and being received from, existing clients.

Strategy	Expected impact	Timeframe for effect	Other impacts
1. Identify the growth capacity within your firm.	Develops an understanding of whether you can expect to achieve growth, or whether you need to put additional capacity in place.	Within 30 days.	Will identify resource requirements.
2. Increase your service range.	Provides additional service areas for your existing clients to purchase.	Will normally show results within 90 days of implementation.	Increases in service range normally require additional resources.
3. Increase client utilisation of existing services.	Your existing clients will purchase additional services. Should increase average fee spend per client.	Will normally show results within 90 days of implementation.	Will require additional resources but cost of acquisition of business will decrease.
4. Increase charge rates.	Should grow revenue and profit line.	Immediate.	May cause some client sensitivity depending on the level of increase.
5. Identify the characteristics of your target client and then focus on acquiring these types of clients.	Should provide a greater focus on the type of client you would prefer to be working with.	A longer term strategy. May take 1-2 years to see the impact.	May cause you to categorise your clients and also identify existing clients who add little or no value to the firm.
6. Have specific new client acquisition objectives e.g. we will acquire five new ‘A’ class clients over the next six months.	Specific targets cause a much greater focus on achieving the outcome and marketing plans have to be more tightly developed.	Normally 6-12 months.	Should elevate the marketing focus of the firm.
7. All partners and senior managers to actively cultivate professional networks.	Should increase and produce a flow of referral work.	Within 3-6 months of network being established.	Likely to lead to referral of non target as well as target clients.

Growth improvement working paper

Objective	e.g. (to achieve net growth of not less than 10%)
Timeframe to achieve objective	
Strategies to be employed	1. 2. 3. 4. 5. 6.
Milestone events to measure progress	1. 2. 3. 4. 5. 6.
Resources required	1. 2. 3. 4. 5. 6.
People responsible for implementation	
Outcomes achieved	1. 2. 3. 4.

Client mix

The client mix of a practice will vary significantly depending on the nature of the practice. The typical general business services practice will have a client mix including:

- small to medium businesses
- contractors and self-employed
- private individuals and investors
- non-profit organisations.

The majority of firms grow their client base at random. As clients are referred to or approach the firm they are taken on as clients. This often means that after a number of years the firm has a substantial client spread. This spread can be of assistance to the practice in reducing its risk exposure and providing a broad range of work that allows the firm to bring on and develop staff from junior to senior levels.

In the early years of a practice almost any client mix is manageable. As the practice matures, however, the client mix will have a significant impact on practice profitability and the ability of the practice to continue to grow. Risk positions begin to develop when you don't have control over your client mix and your client numbers increase with a heavy skewing of client numbers to lower end work. This can often be most easily identified by measuring the average fee per client of the practice. Where the figure drops below $1000, this tends to indicate that the practice requires high volume throughput moving at the extreme to a factory production line.

High volume, low value work can be profitable. And certainly there is no risk of client dependence by the practice. The most common problems caused by such work are:

- fees tend to be at a lower level and part of the market may be price sensitive
- the resources of the principal or partner will be stretched quite thinly across the client base
- typically resource capacity will experience seasonal peaks and lows
- ability to take on higher level clients with significant work and time demands will be limited
- good quality staff will become bored by the lack of challenge from more complex work
- profitability will often be at the lower end of the profit range.

The relationship between your client mix and the average fee per client is an important one. The average partner cannot manage much more than $1.5m in fees. Certainly in larger firms there are partners who manage well in excess of this and even in some smaller firms you find principals or partners who are managing well in excess of $1m in fees. However, if we look at the main stream of small medium size firms the average partner is managing between $400k and $900k in fees. As soon as you have identified your average fee per client you will be able to identify how many clients you can realistically manage. The typical partner will not be able to manage more than 250 clients. This number will be influenced by the average client fee.

As you look at your client mix, the more it is skewed towards a volume of lower end work, the lower the total value of fees you will be able to manage, and the less capacity you will have to take on larger assignments.

To assist in understanding and managing their client mix some firms categorise their clients as A, B, C or D grade clients. These ratings will be based on variables such as fees charged, size of the client, number of services consumed and satisfaction in working with clients. This type of system simply provides an easy-to-see picture of what the client mix looks like and the emerging trends.

The main objective with your client mix should be to be in control of it, and to understand the effect of the number of clients you manage and the average fee per client. With this information you can design your business strategy to pursue the client mix you are after, rather than simply accepting whatever comes.

Diagnostic checklist to assess your performance

Test Method	Method of calculation	Benchmark objective	Your result	Test indicators
1. Average fee per client	Divide gross fees of the practice by your total number of clients.	Will vary depending on your market segment. An average below $1000 will place pressures on you. Ideal position > $3k.		
2. Client dependence	Identify top five clients by fees and then calculate their fee as a percentage of total fees.	No one client > 8% of gross fees and top five clients < 30% of gross fees.		
3. Industry or sector dependence	Calculate client fees by industry or sector group as a percentage of gross fees.	No one sector should represent more than 30% of gross fees.		
4. Number of clients per partner	Measure number of clients being managed by each partner.	For the normal business services general practice client numbers should not exceed 250 per partner. Will reduce significantly based on average fee per client.		
5. Where a client rating system is used, the relative proportion of each group	Percentage of A, B, C & D clients relative to total client population.	Dominance of A & B class clients in client population.		

Strategies checklist to address under-performance

Strategy	Expected impact	Timeframe for effect	Other impacts
1. Develop a target client profile.	Should increase your marketing focus on acquiring the right type of client for your practice.	3-6 months	Should assist in increasing profitability.
2. Where you are client dependent, increase client base to lessen dependency.	Reduced sensitivity should a key client leave the practice or have a change of circumstance.	1-2 years	Will force pace of revenue growth, and require increase in resources.
3. Set partner client numbers and move clients between partners where necessary.	Should smooth partner workload and create capacity for partners with excess client numbers.	1-2 years	Growth will occur more readily.
4. Establish and manage a client rating system.	Will identify clients the practice needs to focus on, and also clients the practice should assess for their value to the firm.	6 months	Where the firm needs to shed clients to create capacity, those clients will be readily identified. Also will provide data for effective delegation of client work.
5. Establish a client acceptance criteria in accepting clients to the firm.	Improved use of practice capacity because you are prepared to say no to some new clients.	Immediate	Your client mix will trend in the right direction because you wont add to existing lower end clients or work.
6. Consider sale or 'firing' of low quality clients.	Will free practice capacity. Should only be used where there are real capacity issues, or where you are prepared to take a more drastic approach.	Within 3 months	Will generally improve staff morale and where sold may provide some capital return.
7. Develop your marketing around the characteristics of your target client.	Should lead to more qualified client referrals and enquiries.	Within 6 months	Will make your existing clients aware of the services you provide – may cause some passive cross sell.

Client mix improvement working paper

Objective	e.g. (to increase the overall proportion of A class clients)
Timeframe to achieve objective	
Strategies to be employed	1. 2. 3. 4. 5. 6.
Milestone events to measure progress	1. 2. 3. 4. 5. 6.
Resources required	1. 2. 3. 4. 5. 6.
People responsible for implementation	
Outcomes achieved	1. 2. 3. 4.

Service range

In terms of increasing revenues and profits, the introduction of new services has many advantages including:

Adding value to existing client base:

- clients perceive they are receiving value for money
- the average fee per client is increased
- attracting new clients through additional services.

Adding value to your practice by:

- relying less on traditional compliance work as the major revenue stream
- better utilisation of existing capacity and providing more interesting work for team members
- maximising the goodwill of the business.

Increasing your service range will also act as a defensive mechanism for your practice. A broader service range will assist in client retention. Where you are planning to introduce new services you should make sure this aligns with your strategic direction. Also think about whether the focus should be on services that create active income i.e. where revenue is only generated from work performed, or passive income i.e. where some revenue may generate without work being performed e.g. trail commissions from financial planning or mortgage broking.

Most practices are dominated by compliance work. Tax and accounting may represent 80 to 90 per cent of fees generated. In these cases you have a ready market for the establishment of new services.

Broadening your service range is not something that happens overnight. In fact, it requires careful planning and implementation. Here are some matters to consider:

Capacity	• Does the practice have the skills and the capacity to deliver the new service?
Market	• This may be obvious, but is there a market for the new service and is it complementary to existing services? • Will this new service attract additional clients to the practice? Are these target clients?
Revenue & profit contribution	• Over time (say within five years), will the new services contribute at least 10% of the current revenue stream? • Is the profit contribution by the new service at least equal to the firm's current threshold profit contribution?
Business analysis	• Is the new service a growth area and can it be delivered within reasonable risk levels? • To proceed to the implementation stage, the answers to the above questions should be yes. If the answer to any of the above matters is no, then you will need to reassess the proposal to introduce a new service.
Implementation	Consider the following points when implementing a new service: • obtain the necessary skills required to deliver the new service. Generally this will require research, attending training and possibly employing or contracting additional resource or even gaining an additional qualification. Talking to and learning from other practitioners who have successfully implemented this new service can also save you a huge amount of time and effort. • appoint a professional who will head up this new service. This will generally be a person who has specialist skills in this area. • establish prices and prepare a financial forecast for the next 12 months for this service including any capital expenditure. • document the systems to deliver the service and develop examples of outcomes for marketing purposes. • target those existing clients with whom you are likely to have immediate success, as early wins are critical to build confidence and provide testimonials. • keep promoting the new service, as it will need to be delivered at least 10 times before it gains momentum.

Expanding your range of services must be viewed as a long-term initiative. Sure, there will be early wins, but the real benefit is from fine-tuning the service over time to be an established revenue and profit contributor.

Diagnostic checklist to assess your performance

Test method	Method of calculation	Benchmark objective	Your result	Test indicators
1. The number of service areas offered by your firm	Documentation of your areas of operation.	Provision of a minimum four service areas.		
2. Revenue contribution by service area	Identify and quantify fees by service area.	Each service area should produce not less than 7% of practice revenues.		

Strategies checklist to address under-performance

Strategy	Expected impact	Timeframe for effect	Other impacts
1. Assess your capacity capability to introduce a new service.	You will understand whether you have existing capacity or whether you need to address the capacity issue first.	Immediate	You may need to secure additional resources.
2. Identify possible new service areas and test market appetite with a small group of existing clients.	Should lead to a hierarchy of new services for introduction.	1-2 months	Will raise some client awareness about your provision of these services.
3. Identify specific resource requirement of new service.	Will identify resource requirements and their cost.	3 months	Should ensure resources are in place to deliver service.
4. Project and measure revenue and profit contributions from new service.	Should confirm financial integrity of step.	1 month	Will establish initial budgets and test financial expectations.
5. Ensure that each new service has a partner responsible for its implementation.	Provides the greatest chance of success when sponsored at a senior level.	3 months	Will cause faster acceptance by both clients and your team.
6. Have a specific marketing program for each new service introduced.	Should cause a faster awareness and acceptance level of the service.	3 months	Where marketing is linked with budgets this should increase accountability level.
7. Unless related services, avoid introducing more than one new service in a year.	Will allow highest level of focus and should assist acceptance level.	1 year	Avoids dilution of impact and allows fine tuning of implementation strategies.

Service range improvement working paper

Objective	e.g. (to introduce one new service over the next year)
Timeframe to achieve objective	
Strategies to be employed	1. 2. 3. 4. 5. 6.
Milestone events to measure progress	1. 2. 3. 4. 5. 6.
Resources required	1. 2. 3. 4. 5. 6.
People responsible for implementation	
Outcomes achieved	1. 2. 3. 4.

Practice maturity

This is not an area that you have a lot of control over and it can only be changed with time.

Mature practices should command values at the higher end of the valuation range. This is because they should exhibit most of the following characteristics:

- an established brand and presence
- have good operating systems in place
- have developed longer-term client relationships, with clients committed to the firm
- a good quality client base
- established infrastructure
- established staff relationships
- a network of other professionals and referral sources
- a history of financial performance
- a history of maintainable growth
- the absence of silo management – clients have contact with multiple people in the firm.

Many of these characteristics come with time as the practice evolves and moves through different growth phases. Having said this, time is not the only ingredient. There are practices that have been around for many years but which on assessment could still be described as immature. The level of active management of the practice will have a significant impact on this. Practices evolve in one of two main ways. The majority evolve in an unstructured way. The principals or partners are good at their profession, and they provide a reasonable service to those clients who come to the firm. Growth comes from being reactive to existing client growth and from referrals. This type of practice will have a very broad range of clients with the client base, in numbers, being dominated by smaller clients. These are generally good quality firms – however the focus of the principals and partners tends to be on the profession of accounting rather than the business of accounting.

The alternative is a firm that is developed strategically in a structured way. The business model and objectives are clear and detailed. And the operation of the practice is driven by this model and its objectives.

If your practice doesn't have age on its side, then the more strategic and structured your practice is the greater the number of maturity characteristics it will exhibit. Test yourself against the maturity characteristics we have identified in this section and then where they are underdeveloped in your firm, start to work on them strategically. The only areas you will be limited in are where there is an absolute time requirement e.g. years of association with clients.

Your objective should be to exhibit the characteristics of practice maturity in the shortest possible time frame.

Maturity improvement working paper

Objective	e.g. (to have in place expected characteristics of a mature practice)
Timeframe to achieve objective	
Strategies to be employed	1. 2. 3. 4. 5. 6.
Milestone events to measure progress	1. 2. 3. 4. 5. 6.
Resources required	1. 2. 3. 4. 5. 6.
People responsible for implementation	
Outcomes achieved	1. 2. 3. 4.

Staffing

Profitability and work management efficiency go hand in hand. If your workflow efficiency is struggling then it will show up in your profitability fairly quickly.

You have a busy practice. There always seems to be a lot on — plenty of things to do and you never seem to be fully on top of all the work demands. But even with all this activity, profitability just isn't where is should be. And even more frustrating is the fact that the partners are overworked and constantly under pressure. You think the only way to get on top of this is to work harder, put in those extra hours.

Any of this sounding familiar?

The answer to your problem could be as simple as examining your existing staff mix. Sometimes workflow efficiency falls away or is under pressure simply because you don't have the right mix of people in your practice.

Who makes up the staff mix?

Let's have a look at a typical accounting practice, the people it employs and their likely skill sets.

Partners	Normally experienced practitioners with a broad range of skills and sometimes specialist skills. Beyond their technical expertise they are also key to the business in the acquisition of clients, maintenance of client relationships and general practice management. Typically they are managing a broad range of issues at any one time.
Managers	Would usually have 5+ years technical experience and are generally proficient with the technical aspect of the work. They may also have a technical specialisation and are the people we are most likely to go to, to handle the more complex issues or questions. They are also expected to be able to manage the work and production of a team, and reliably work with clients.
Intermediates and seniors	Generally qualified and on their way along the professional career path. Normally reliable and efficient in their workflow. They may not have the same depth of technical expertise or experience in managing people.
Graduates	Plenty of enthusiasm and energy but still with a fair amount of learning to do. They need support at a technical level and ongoing review of their work progress.
Bookkeepers and support staff	Provide strong back office support for the practice and some levels of client interaction.

All of these professional job roles are important and each has a part to play in a busy practice. Take one out and you can either have people working without adequate supervision and access to senior staff or alternately seniors working on jobs that cannot support their charge rate. In both cases workflow efficiency suffers and quickly impacts on the bottom line.

Ask yourself, why is it that many accounting practices have high write-off levels? As a profession we have almost come to accept double digit write-off levels as the norm. This just doesn't make sense. In many cases the underlying reason behind high write-off levels is a poor staff mix.

Where you don't have a graduation in the experience and skill levels between the partners and the graduate professional staff you will often find:

- jobs delayed waiting for partner review
- partners spending significant time reviewing and working on low-level jobs because they have no one to delegate the function to
- high level of job reworks due to inadequate supervision throughout the job process
- frustration of junior staff who can't get access to partner or senior time
- opportunities missed because the partners do not have adequate time to spend with their clients.

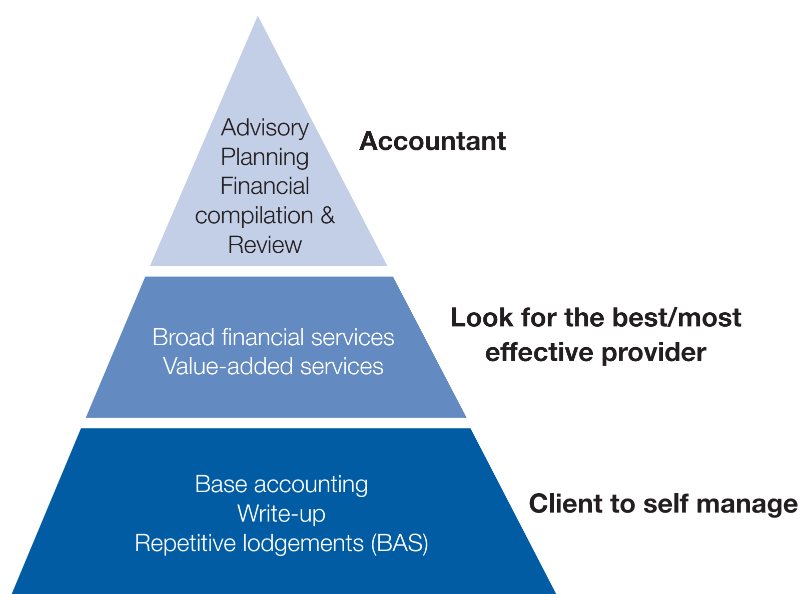
So what's the answer?

A good staffing mix will see a partner with a manager; two or more seniors and intermediates; and two graduates.

Allowing for your support staff, this will create a partner/staff ratio of at least 1:7 – an ideal level to achieve good staff leverage and one which will allow you to drive your profitability into the upper quadrant.

Take a moment to review your staff mix. It may be holding back the development and profitability of your firm. Once you have worked out the staffing mix you need, make sure that the next time you recruit you bring on people at the right level.

The other issue to consider is the nature of the work being undertaken by your practice and changes that may be occurring in your work program. Certainly there is evidence in the profession that there is a change in the type of work being undertaken.



Work for most of us falls into these three segments. At the base we have all of the write-up work, base level repetitive compliance requirements and the more straightforward accounting functions. This has been typically the domain where we have engaged graduates and less experienced staff who have performed much of the hackwork, an important part of the overall accounting function, but one that could be capably delegated and managed.

In the middle is the value-added work. This is the more specialist work, business advisory, financial planning, valuations, specialist tax advice and much more. Some firms have found their way into this space, but most have not mastered it. Often the general compliance demands mean that there is not enough time or resources to focus on this area and at times it is a bit hit and miss.

At the top of the pyramid is the work where principals, partners and senior staff spend most of their time. Review and sign-off, financial compilation, audit and other attestation work, and tax planning can consume much of our time.

When you look at it, for the typical public practice firm, it is this top layer of the pyramid where we earn our salary. This is where we get our labour return. The good news is that this work is relatively safe and will continue to be there. So your salary should remain intact. This is not, however, where firms have typically made their profits. Profits have been largely generated from the work at the base of the pyramid. This has been where you could employ less expensive labour, charge them out at a multiple of around three times direct labour cost and providing you could keep the process reasonably efficient, then there was money to be made on a reliable and predictable basis.

The problem we have is that this is the work area that is eroding. Clients are taking back some of this work, in some cases with our encouragement. Computer accounting software programs are promoting and accelerating the transition. There is also a growing industry of bookkeeping services where this base-level write-up work can often be delivered at a much lower cost. As this work disappears so does some of the profit base of the traditional firm. Another impact of this is that there is less sustainable work for graduates and less qualified staff. With this will come a pressure on staff mixes as work demand moves around.

In some cases this trend is leading to a reduction in demand for lower qualified staff and an increase in demand for more senior staff. To manage this effectively you need to monitor the work demands of your practice and then ensure that you match your staff mix to the work mix you have.

Diagnostic checklist to assess your performance

Measurement	Method of calculation	Benchmark objective	Your result
Staff turnover	Annual staff resignations, terminations and retirements divided by average staff number for the year.	Staff turnover rate should be within 10%.	
Write-off levels	Total net write-off on jobs, as a percentage of gross fees.	Should be less than 6%.	
Surplus capacity percentage	Available capacity less gross fees as a percentage of available capacity.	Should be less than 10% unless practice is moving through a planned growth phase.	

Strategies checklist to address under-performance

Strategy	Expected impact	Timeframe for effect	Other impacts
1. Review your work program and identify levels of staff required for the practice.	Achieve a better match of work to worker.	Will depend on your recruitment requirements – more senior staff harder to attract.	Once in place should reduce write-off levels.
2. Ensure you have a middle tier of staffing – one to two seniors or manager per partner.	Will free up partner time and reduce demands dealing with lower level queries.	3 months	Reduce frustration level of junior staff who can't access partners or having reviews delayed.
3. Have a clear delegation system in place – not everything has to be managed by a partner.	Authority and responsibility levels for all staff will lead to better work throughput.	3 months	Better access for clients and greater job satisfaction for staff.
4. Understand your staff motivators and implement programs to address these e.g. performance feedback, team building exercises, good work environment, market-based remuneration, coaching and mentoring.	Reduced staff turnover and attendant costs.	6-12 months	Improved staff morale, reduced sick leave and a more enjoyable work environment.
5. Provide staff with career paths.	Will increase your average years of staff retention.	1-3 years	May create your partners of the future and your own succession path.
6. Always be in the market for good quality staff.	May assist in picking up scarce senior staff when they come on to the market.	Ongoing	Tends to force a growth mentality onto the firm.
7. Establish a graduate development program.	A grow-your-own strategy that may develop your senior staff of the future .	Ongoing	Will place an increased focus on staff retention to ensure that you don't lose good people who you have trained.

Staffing improvement working paper

Objective	e.g. (to improve net staffing by 10%)
Timeframe to achieve objective	
Strategies to be employed	1. 2. 3. 4. 5. 6.
Milestone events to measure progress	1. 2. 3. 4. 5. 6.
Resources required	1. 2. 3. 4. 5. 6.
People responsible for implementation	
Outcomes achieved	1. 2. 3. 4.

Leverage

Leverage is something that should interest every principal or partner. At its basic it is about creating more with less. Where you have scarce resources or expensive resources, managing and making the most of leverage is critical. Most principals or partners wish they had more time. It is the greatest limiter in what can be achieved and the problem is accentuated because you cannot readily replicate what you do. Or can you?

Effective leverage will increase revenues and profits. At the same time it will reduce risks and frustrations.

Leverage can be achieved in a number of ways, including through:

- people
- systems
- business models.

Professional services businesses are seen as personal services businesses. And in most cases they are. The majority of practices are small in people numbers and dominated by the key principal or partner. Most of the direct revenue and business generation comes from one or a few people. A by-product of this has been that most principals or partners require the majority if not all of the work flow to pass through them. An argument to support this has been the need for quality control, a principle everyone would support. As a result, the growth and revenue capacity of a firm is normally limited to the available time of the key people. Once they are 'timelocked', growth stops. This tends to set a finite limit around what a practitioner can achieve, and a reasonably predictable range on revenue and profit returns.

Leverage is one of the ways to extend the capacity and range of what can be achieved.

People leverage comes in two forms – low and high. Low level people leverage is where you engage staff to perform support functions. This may include secretarial work, basic bookkeeping, write-up work or any of those functions that are typical back-office roles within a professional services firm. This will free up the principal or partner to spend more time with clients and on more complex work. The result of this should be more chargeable time at partner rates, with some lower level work charged out at lesser rates. Whilst there are still limitations, you achieve the best outcome for the time available. This form of leverage allows you to get the best out of yourself.

Practices producing fees in the range of $300K to $700K per principal, per annum, generally are engaging low-level leverage to some degree.

High-level people leverage occurs when you employ people to do what you do; that is care for clients and deliver high-level services. This doesn't occur instead of low-level leverage, but in addition to. It will remove the ceiling on the number of clients the practice can take on. It is not just limited to what you can do. There are a number of seniors able to manage clients and complex work assignments. High-level leverage will normally allow principals or partners to manage fees in the range of $700K to $1.5 million per annum.

The higher the level of leverage you employ, the more important it is to have strong quality control and operating systems in place.

A good staffing mix will see a partner with a manager; two or more seniors and intermediates; and two graduates.

Allowing for your support staff, this will create a partner/staff ratio of at least 1:7 – an ideal level to achieve good staff leverage and one which will allow you to drive your profitability into the upper quadrant.

Take a moment to review your staff mix. It may be holding back the development and profitability of your firm. Once you have worked out the staffing mix you need, make sure that the next time you recruit, you bring on people at the right level.

Systems leverage comes when your business systems and processes can complete or assist what otherwise would have been a labour-based function. Strong systems can take the human element out of the equation. These systems will either be focused on reducing costs or in some cases actually driving revenues. Systems linked with technology delivery tend to achieve the best result.

In developing your systems the greatest gains will be taken from systems that deliver:

- a quality control process
- automation of routine and repetitive work
- effective delegation of work functions
- management of job progress and workflow
- reduced documentation and paper flow
- automated client follow-up.

Business model leverage occurs when your business model drives growth and revenue in its own right. The typical professional practice business model is an hours-charged model. Under this model, the aim is to maximise the hours being charged and to maximise the charge rate of those hours. Delivered effectively it will produce strong profitability. The limitations tend to be resourcing the firm with sufficient people to deliver the hours, and acquiring the clients willing to pay the charge rates employed. These two primary limiters create the boundaries for the firm.

If this is the case, then the only way to overcome it is to modify your business model. This could be achieved by introducing a level of passive income into the firm. The most common examples of this in accounting practices would be the introduction of financial planning or mortgage broking services, where there is some level of recurring income. Passive income normally has a time period to produce a meaningful impact within a firm, but once it starts it will normally accelerate and drive significant profit improvement.

Diagnostic checklist to assess your performance

Measurement	Method of calculation	Benchmark objective	Your result
Workflow turnaround time	Average number of days from receipt of work till completion of job.	Have a process in place for work completion within 30 days of receipt or as agreed with client.	
Partner staff ratio	Number of staff per partner.	A partner staff ratio of 1:7 or greater should provide high-level leverage, providing it includes some senior staff managing client portfolios and complex work matters.	
Passive income	Percentage of passive income to gross revenue.	Once passive income exceeds 10% of gross revenue it begins to make a meaningful contribution to the business.	
Premium services	Delivery of services where a premium above standard charge rate is achieved.	Your service mix should include services that produce revenue greater than 15% of total fees and where those services command a premium greater than 30% of standard charge rates.	

Strategies checklist to address under-performance

Strategy	Expected impact	Timeframe for effect	Other impacts
1. Set partner staff ratio levels.	Partners will have a clear understanding of the number of staff they need to manage, and the leverage levels required.	Will depend on current status, but improvement should be achievable over one year.	Forces partners to delegate, manage higher level work and grow their client base.
2. Delegate client management.	Managers and seniors should be managing C & D style clients.	1 year	Grows the skills of your seniors and managers and frees up partner time for high-level work and client acquisition.
3. All routine work delegated.	Work should be driven to the lowest skill level where it can be efficiently completed.	1 year	Will provide greater work variety for all staff, increasing job satisfaction.
4. Set a minimum requirement of at least one manager and one senior for every partner.	Forces partner development and creates staff career paths.	1 year	Will open up internal succession opportunities.
5. Identify significant processes that can be automated.	Increasing levels of systemisation will produce cost savings.	3-6 months	Will enhance quality control and risk management.
6. Assess passive income opportunities for the firm.	Enhanced revenue and profitability.	1 year	Revenues created that are not as people dependent.
7. Identify specialist services appropriate for your client base and where a premium charge rate could be applied.	Enhanced revenue and profitability.	1 year	Firm reputation grows through differentiated service offering.

Leverage improvement working paper

Objective	e.g. (to increase partner to staff ratio to 1:6)
Timeframe to achieve objective	
Strategies to be employed	1. 2. 3. 4. 5. 6.
Milestone events to measure progress	1. 2. 3. 4. 5. 6.
Resources required	1. 2. 3. 4. 5. 6.
People responsible for implementation	
Outcomes achieved	1. 2. 3. 4.

Systems and procedures

Systems are the lifeblood of a business. They allow a business owner to work on the business not in it. They increase the sales value of the business, they add to profitability, they reduce the incidence of problems within a business and they enable the owner to take a holiday without the business shutting down!

All good reasons for the implementation of systems. Then why aren't they done for many businesses (including professional practices)? Answer: because they need to be planned, documented, enforced, reviewed and updated to be of any use.

Let us do a stocktake of the areas that your practice should have documented systems in place. Tick **Yes** if you have documented systems in place which are updated and followed. If you have systems in place which are not documented or updated, tick **Maybe** and tick **No** if there are no systems in place.

Area	Yes	Maybe	No	Comments
Budgeting				
Computer (hardware and software)				
Debtors control				
Equipment				
Filing system				
Financial reporting				
Marketing				
Personnel				
Training				
WIP management				
Work processing				
Work scheduling				

If you have a number of ticks in the **Yes** column, you understand the value of good systems. If the ticks are in the **Maybe** or **No** columns, then you should think seriously at dedicating resources into developing or improving systems within your practice.

This needn't be hard. Luckily for accountancy practitioners there are generic and proforma systems available on the market. These can be a great cost-effective base to start from to help build and document appropriate systems for your practice. The time saving from not having to start from scratch is significant.

Diagnostic checklist to assess your performance

Test method	Method of calculation	Benchmark objective	Your result	Test indicators
1. Documentation of practice systems	Evidence of documented practice systems used in operation.	All key operating areas of the practice are documented and systems adhered to by staff.		
2. Single system approach by all staff	Review of working papers and files demonstrate single system approach within the firm.	No evidence of silo approaches in firms where different partners operate in different ways or where staff have operational discretion.		
3. Peer reviews	Review of professional body Quality Assurance report.	Receipt of an unqualified QA report.		
4. Risk management system	Documented risk management system.	Fully documented risk management system and evidence of annual review.		

Strategies checklist to address under-performance

Strategy	Expected impact	Timeframe for effect	Other impacts
1. Conduct a systems audit.	Should identify systems gap and areas that need to be addressed.	1 month	May identify quality control or risk management exposure.
2. Create a hierarchy of systems or procedures requirements.	Will provide a to do list and address the most important areas first.	3 months	Should assist if you don't know where to start or are overwhelmed by the extent of the work.
3. Allocate systems development to people responsible for operational areas.	Delegation of the work should produce a faster and better result.	3 months	Involvement of key members of the team should increase the level of systems awareness.
4. Buy in or subscribe to systems & procedures providers.	Will shorten time frame and may lower cost of systems development.	3 months	Allows you to access what is already working. May be closer to best practice.
5. Timetable and milestone change process.	Should assist in ensuring the job is done.	3-6 months	Will maintain the pressure to deliver and elevate the focus.
6. All partners to agree a single system approach.	Staff buy in will only occur when supported by partner implementation.	6 months	Will create efficiency where all the staff are using a single system or where work flow or staff move across partner teams.

Systems and procedures improvement working paper

Objective	e.g. (to have all key practice systems documented and operational within our team)
Timeframe to achieve objective	
Strategies to be employed	1. 2. 3. 4. 5. 6.
Milestone events to measure progress	1. 2. 3. 4. 5. 6.
Resources required	1. 2. 3. 4. 5. 6.
People responsible for implementation	
Outcomes achieved	1. 2. 3. 4.

Write-off levels

Year in and year out practitioners give away large amounts of money in the write-off levels we accept within our practices. This money isn't going to a good cause – it's simply going down the drain.

Take a moment to think about it. Consider the gross fees of your firm. Now work out what one per cent of that number is. For example, with gross fees of $500,000 every one per cent represents $5,000. Now start to think about your write-off levels — that's if you've taken the time to work them out. For such a firm, the write-off level would represent $50,000. How many firms with fees of $500K per annum can afford to write out a cheque to a charity for $50,000 and are prepared to do so every year? The answer is not many, if any.

Yet as a profession we seem to be prepared to accept double-digit write-off levels as an acceptable part of life. It just doesn't make sense.

To assess your write-off levels, you can go to your practice management system and pick up the number that represents your write-off level for the year. Alternately, if you aren't using such a system or it isn't up to date, then you can come up with a pretty good approximation by looking at your revenue capacity for a year after adjustment for your write-off expectation. Then compare this number with your actual revenues. Be careful though, you may cringe a little at the result.

It's important to understand that every practice has write-offs. The reality is they are unavoidable. We all have those jobs where it just doesn't go right and there is a big 'rip up' at the end. The key is to drive down the number of times it occurs and ensure that it is not a part of the culture of the firm. And that's where practice management comes in.

As a guide, the following table provides you with a suggestion on write-off levels to work with across your firm.

Less than 2.5%	Best practice
2.5% to 5%	Good
5% to 8%	Average
8% to 12%	Requires review
Greater than 12%	Structural management problems exist with the practice

If you are experiencing high write-off levels, it will generally be for one of the following reasons:

- poor job-flow management
- poor quality records from the client
- lack of job systems and procedures
- a mismatch between the work and the skill set of the person assigned to the job
- lack of appropriately qualified staff
- lack of adequate staff training
- inadequate job supervision
- fee for the job below a realistic level
- inappropriate charge rates.

You can see from this list that we are either looking at an internal problem in terms of work and staff management or a problem with your client mix and how work is being billed and charged.

If your write-off levels are too high then have a look at your practice. You should be able to identify fairly quickly where the problems are. Then go to work on them – a piece at a time.

What you are trying to achieve is performance modification and positive progress. As an example, if you have a current write-off level of 15 per cent then it is unlikely that you will be able to turn this into a 5 per cent level over a short period of time.

An improvement of two to three per cent over a six-month period should, however, be achievable. Improvement will all be about incremental steps.

And those steps are worth it. How much is a one per cent difference worth in your firm? It may take a little time and effort, but get it right and you will be a beneficiary many times over. And in the process the next time you go to make a donation to a charity, you have a greater capacity to be generous in your giving to a good cause.

Diagnostic checklist to assess your performance

Measurement	Method of calculation	Benchmark objective	Your result
Write-off levels	Gross fees written off from work in progress divided by gross revenue capacity for the year.	Maintain write-off levels below 6% per annum. Where write-off levels are in excess of 10% significant corrective action is required.	

Strategies checklist to address under-performance

Strategy	Expected impact	Timeframe for effect	Other impacts
1. Set write-off expectations and communicate to all of the team.	Higher accountability will increase the performance focus.	Should be immediate.	Forces partners to take a more active approach to management.
2. Measure write-off performance on not less than a monthly basis.	Increased visibility will highlight problem areas and make people more conscious of performance.	3 months	Performance may improve through competitive pressures.
3. Have an active job management system in place that identifies job budgets and actuals.	Issues will be identified at an earlier stage.	1-2 months	Will allow a level of team management, where staff have access to information on what is happening.
4. Be prepared to decline work where the record quality is poor, or alternately charge for it.	Should produce better records quality from clients.	3-6 months	Reduces staff frustration where the problem is outside of their control.
5. Have clear procedures in place for all jobs, supported by standard work papers and checklists.	More efficient processing of job stages.	3 months	Staff will have greater certainty on what is expected.
6. Ensure that job allocation process is appropriate.	Staff allocated work should be capable of completing the work.	Immediate	Significant reduction in review and rework time.
7. Have appropriate job supervision and review processes in place.	Staff will have access to assistance throughout the job and receive feedback on job progress.	Immediate	Should reduce level of rework and time required in rework of problem areas.
8. Fees quoted on jobs are appropriate for the work required.	Clear alignment between reasonable time to complete work and fee quoted.	Immediate	Remove staff frustration where fees quoted create a no win position.
9. Work to be driven down through the firm to the level where it can be effectively completed.	Avoids high charge rate staff completing low charge rate work.	Immediate	Matches work to worker and forces senior staff to engage in more complex work.

Write-off level improvement working paper

Objective	e.g. (to improve net write-off by X%)
Timeframe to achieve objective	
Strategies to be employed	1. 2. 3. 4. 5. 6.
Milestone events to measure progress	1. 2. 3. 4. 5. 6.
Resources required	1. 2. 3. 4. 5. 6.
People responsible for implementation	
Outcomes achieved	1. 2. 3. 4.

3. Selecting your succession option

This section looks at the different succession options available to you. A brief description is provided of each option and then we identify some of the key issues you need to consider with this option. Some issues will present themselves with virtually all options, whereas others are more unique to a particular option. Many of the issues raised in these sections will be negotiable between the parties. Issues raised are common positions that frequently arise in a transition.

In proceeding down a succession pathway, it makes sense to have considered in advance some of the issues you may face. It will allow you to be better prepared for them.

Sale of practice

Currently the most common succession option — in most areas there is an active market for good quality accounting firms. There are a significant number of mergers and acquisitions being completed at the moment as many existing firms are looking to bulk up through acquisition. Larger firms who are looking for accelerated growth are also completing tuck in acquisitions. This may present a succession opportunity or a transition path for your succession. In addition there are always practitioners seeking to enter public practice by way of acquisition of an existing firm.

It is likely that there will be an increasing number of firms coming on to the market over the coming years. This may lead to supply exceeding demand. If this is the case then buyers will have a greater number of firms to choose from and will become more selective. Where your firm ranks in the top quartile of performance benchmarks you are better positioned for acquisition.

You will need to decide on the timing of your sale. Accept that you may not be able to nominate your precise exit time. Rather you should work to an exit time window. This window may cross over one to two years. A range of factors including market conditions will determine the best exit opportunity time. It's a good idea to have some flexibility here.

Sale of practices are commonly a sale of business assets, rather than the underlying entity structure. Typically a purchaser will purchase the plant, equipment and goodwill only. Debtors and work in progress, unless otherwise agreed, tend to be the responsibility of the vendor.

Checklist of typical buyers

Your practice is most likely to appeal to someone with existing public practice experience but who would like to take over an established business rather than go through the set up and establishment process themselves.

Typical buyers	Comments/potential buyers
For fees $500K and less: • Employees from other public practice firms looking to go into practice by themselves • A key employee within your own firm • First-time entrants into public practice • A tuck-in merger by a small partnership	
For fees more than $500K: • An acquisition or tuck-in merger by an existing practice • Acquisition by one or more employees – employee buyout	

Sale of practice checklist

Issue to address	Comments	Date completed
1. Terms and conditions required on sale		
2. Willingness to sign a restrictive covenant		
3. Willingness to accept any part of the settlement proceeds being deferred		
4. Willingness to accept a part of the consideration being contingent on future revenue performance of the practice		
5. Willingness to accept any claw-back provisions		
6. Expected price		
7. Period of time prepared to assist with handover and transition. Do you require payment for your time?		
8. Time period allowed for due diligence		
9. Requirement for prospective purchasers to enter into a confidentiality agreement		
10. Availability of historic information on client base, fees by client and fees by service range		
11. Impact on staff employment contracts		
12. Is all work in progress to be billed out prior to settlement?		
13. Are there leases that will need to be transferred?		
14. Solicitor to be instructed to draft sale contract		
15. Method of marketing the practice		

Sale of a fee parcel

This option will most likely occur in one of two different situations. You may be looking to sell off a part of your practice. Alternately you may be in a partnership arrangement where either the other partners do not wish to purchase your fees or by prior agreement it is anticipated that each partner is expected to deal with their fees in isolation.

The sale of a fee parcel normally does not involve the transfer of any assets other than the clients. As such it should be a simpler transaction. The size and quality of the fee parcel will determine the time required to complete the sale. A typical buyer will look for database records that can stand up to due diligence and which provide clear details of the clients, client groupings, historical fee levels over the past three years and the range of services being provided. They may also want to examine your tax invoices to assess services being provided against fees charged. The better the quality of your records, the easier the sale process is likely to be.

You will need to decide on the timing of your sale. Accept that you may not be able to nominate your precise exit time. Rather you should work to an exit time window. This window may cross over one to two years. A range of factors including market conditions will determine the best exit opportunity time. It's a good idea to have some flexibility here.

Checklist of typical buyers

Typical buyers	Comments/potential buyers
For fees $500K and less: • First-time entrants to public practice • A key employee within your own firm • An existing sole practice or small partnership	
For fees more than $500K: • An acquisition or tuck-in merger by an existing practice • Acquisition by one or more employees – employee buyout	

Sale of a fee parcel checklist

Issue to address	Comments	Date completed
1. Terms and conditions required on sale		
2. Willingness to sign a restrictive covenant		
3. Willingness to accept any part of the settlement proceeds being deferred		
4. Willingness to accept a part of the consideration being contingent on future revenue performance of the practice		
5. Willingness to accept any claw-back provisions		
6. Expected price		
7. Period of time prepared to assist with handover and transition. Do you require payment for your time?		
8. Time period allowed for due diligence		
9. Requirement for prospective purchasers to enter into a confidentiality agreement		
10. Availability of historic information on client base, fees by client and fees by service range		
11. Is all work in progress to be billed out prior to settlement?		
12. Solicitor to be instructed to draft sale contract		
13. Method of marketing the practice		

Progressive sell down

This option seeks to achieve a full sale of the practice or the fee parcel on a progressive basis. This may be done in conjunction with the admission of a new partner or alternately a progressive sell down to existing partners.

This succession option has two key features. The first is the negotiation of the price for the sale. The second is the underlying agreement by which the sale will be completed over time. This agreement is quite critical because under this option there is not a single succession event but rather a progression to the completion of the sale. This extended time frame increases the risk with the sale. It is important to ensure that your agreement not only locks in the purchaser but also provides appropriate protection in the event of any default. Good legal advice is essential and the agreement should always be executed under an enforceable contract.

Your buyer will look at the practice and its performance over the past three years. Normal review and due diligence should be expected. There is also an additional element in this type of transaction. You and the buyer will be working with each other over the period of the progressive sell down. This may be a number of years. There needs to be a reasonable cultural fit. You both need to be able to get on and work together. This is an area you need to satisfy yourself on.

Checklist of typical buyers

Typical buyers	Comments/potential buyers
1. Your existing partners	
2. A staff member being admitted to partnership in the firm	
3. A new partner introduced to the firm	

Progressive sell down issues checklist

Issue to address	Comments	Date completed
1. Terms and conditions required on sale		
2. Partnership or shareholders agreement		
3. Agreement in relation to progressive sell down amounts and timelines		
4. Willingness to accept any part of the settlement proceeds being deferred		
5. Willingness to accept a part of the consideration being contingent on future revenue performance of the practice		
6. Willingness to accept any claw-back provisions		
7. Expected price		
8. Time period allowed for due diligence		
9. Availability of historic information on client base, fees by client and fees by service range		
10. Is all work in progress to be billed out prior to settlement?		
11. Solicitor to be instructed to draft sale contract		
12. Where a new partner is being introduced consider terms of any existing partnership or shareholder agreement and any pre-emptive rights		

Merger

There has been a significant increase in merger activity. Mergers as a route to managing succession will be popular particularly where practitioners are engaging in long-term planning of their succession. Using this option is a two-step approach. You will need to first manage the challenge of a merger, with your succession exit being the second stage.

It is essential that all partners in the merged firm have a clear and common understanding of the arrangements. Your partnership agreement has an increased importance under this option. It should clearly detail not only the relationship and arrangements between the partners, but it should also document how and when succession will be completed. Where possible, you should avoid the documentation of the succession arrangements being deferred. They should be included in the original merger and partnership agreement.

In most cases the valuation of your share, on ultimate exit, from the merged practice will be determined by the performance of the practice. This means that you need to be confident of the performance of the merged firm and your ability to work with the partners in the firm. In most cases a merger will take between six and eighteen months to settle in. During this time you should expect the practice to under-perform. The extent of this under performance will vary based on the merger. You should allow sufficient time post merger for practice performance to be realised that will produce a reasonable valuation return. Normally this would mean a gap of three to five years between merger and your succession exit.

Again ensure that there is a good cultural fit between the partners. You will be working with them for a number of years.

Not surprisingly mergers tend to be the most complex succession option. A merger has much greater impact on all the stakeholders in both firms. It will require significant planning, timing and patience. Throughout the process there should be a high level of communication with your staff. There also needs to be strong attention to the detail.

Checklist of typical merger partners

Typical buyers	Comments/potential buyers
For fees $500K and less: • Merger of two sole practitioner firms • Merger of a sole practitioner with an existing partnership firm	
For fees more than $500K: • An acquisition or tuck-in merger by an existing practice	

Merger issues checklist

Issue to address	Comments	Date completed
1. Terms and conditions on merger		
2. Requirement for all parties to enter into a confidentiality agreement		
3. Agreement on the new entity structure		
4. Partners' remuneration and access to profits		
5. Agreed decision making process and who will act as managing partner		
6. Partnership/shareholders agreement		
7. Agreement on terms including management, dispute resolution, exit provisions, valuation formula, and capital investment		
8. Agreement on services to be provided		
9. Agreement on charge rates and partner expectations		
10. Agreement on client profile and any existing clients who may be outside of the new practice requirements		
11. Time period allowed and scope of due diligence		
12. Location and number of offices to be maintained		
13. Physical space requirements		
14. Quality control and operating systems to be used		
15. Software platforms for accounting, tax and practice management including agreement on database		

Issue to address	Comments	Date completed
16. Organisation chart and staff structure		
17. Consideration of any staff redundancies		
18. Agreement on employment terms for all staff and review of wage levels for parity		
19. Capital requirements and funding for the practice		
20. Bankers for the practice		
21. Practice name		
22. Professional indemnity insurer and level of cover required		
23. Availability of historic information on client base, fees by client and fees by service range		
24. Is work in progress of the firms to be billed out prior to merger?		
25. Solicitor to be instructed to draft merger agreement and partner/shareholder agreements		
26. Entity registration and advice to professional bodies		
27. Development of merger plan and timetable		
28. Allocation of merger responsibilities		
29. Communication and PR plan		
30. Client advice		
31. Employment agreements for all staff		

Internal succession

This succession option anticipates that senior staff will be ready to progress on to partnership and that partner retirement will be managed in part through the appointment of new partners. Internal succession can occur by chance or through a planned and developed practice succession program. Succession by chance provides no real certainty. There may be the best of intentions within the firm but without proper planning realisation will always be at risk.

Effective internal succession requires:

- growth within the practice that facilitates progression to partnership
- recruitment of staff who aspire to and are capable of being partners
- a manager and partner development program
- practice performance that makes the firm attractive for partnership aspirants.

In some firms there are capital funding arrangements that assist incoming partners to take up equity in the firm. These may include a partial contribution from profit entitlements.

Internal succession programs need to be well developed over time. Such programs are much more effective than those where it is dealt with as a one-off event.

Checklist of typical internal succession candidates

Typical buyers	Comments/potential buyers
Will normally be an existing manager within the firm. Ideally, should have a minimum three-year tenure with the firm.	

Internal succession issues checklist

Issue to address	Comments	Date completed
1. Terms and conditions required on sale/ transition of practice equity – may be covered within existing partnership/ shareholder agreement		
2. Willingness to sign a restrictive covenant		
3. Willingness to accept any part of the settlement proceeds being deferred		
4. Willingness to accept a part of the consideration being contingent on future revenue performance of the practice		
5. Willingness to accept any claw-back provisions		
6. Expected investment		
7. Funding requirements and financial arrangements between incoming partner and retiring partner		
8. Whether there will be any due diligence process		
9. Remuneration and access to profits for incoming partner		
10. Availability of historic information on client base, fees by client and fees by service range		
11. Terms for dealing with work in progress		
12. Solicitor to be instructed to draft sale contract and variation to partnership/ shareholder agreement		
13. Does this involve a partnership resettlement and if yes the requirement for ABN registration or variation		
14. Communication process for clients and staff		

Admission of a new partner

Another way to manage succession is through the introduction of a replacement partner, externally sourced. Introducing external partners normally increases the risk to the firm. Not only is there a need to manage the transition of the exiting partner, but also the requirement to manage the induction of a new partner, who is perhaps not well known to the rest of the partner group. This option may be used as an alternative where internal succession is not possible and where the existing partner group do not want to acquire the retiring partner's interest. An example of where this option could be used is where there is not a significant age separation between the partners and where the continuing partners do not want to take up the capital of the first partner to retire.

This option has a higher degree of success where the incoming partner is introduced into the firm twelve months in advance of the partner transition. This may be possible through appointment as a salaried partner for the first twelve months. Again documentation is critical here, both in terms of the partnership agreement and the exit agreement for the retiring partner.

Managing a partner transition of this type will require a high degree of planning and adequate time. Key stakeholders where the transition will need to be managed include:

- the existing partner group
- staff
- clients

Checklist of typical partner candidates

Typical buyers	Comments/potential buyers
• a partner from another firm looking to change firms • a manager from another firm looking to change firms • a sole practitioner seeking to be part of a larger firm • an experienced accountant seeking to enter public practice	

Admission of a new partner issues checklist

Issue to address	Comments	Date completed
1. Terms and conditions required on sale		
2. Agreement of existing partners/shareholders for an equity share in the firm to be sold to a new entrant		
3. Requirements of continuing partners in relation to partner selection		
4. Agreement of incoming partner to existing partner/shareholder agreement		
5. Remuneration and access to profits for incoming partner		
6. Working capital contributions required by firm		
7. Transition of clients to incoming partner		
8. Identification of partner role and interaction with staff		
9. Transition timetable		
10. Willingness to sign a restrictive covenant		
11. Willingness to accept any part of the settlement proceeds being deferred		
12. Willingness to accept a part of the consideration being contingent on future revenue performance of the practice		
13. Willingness to accept any claw-back provisions		
14. Expected price		
15. Time period allowed for due diligence		

Issue to address	Comments	Date completed
16. Requirement for prospective purchasers to enter into a confidentiality agreement		
17. Availability of historic information on client base, fees by client and fees by service range		
18. Is all work in progress to be billed out prior to settlement?		
19. Solicitor to be instructed to draft sale contract and or variation to partnership agreement		

Buyout by existing partners

This option allows for arrangements between existing partners. It may include all remaining partners taking out the share of the retiring partner under pre-emptive rights, or by arrangement between individual partners within the firm. Arrangements of this type may be contemplated within the partnership agreement or alternately may be discussed and agreed within the partnership group over time.

Where you have expectations that the partnership or certain of the partners will take out your partnership interest, it is a good idea to build into your partnership agreement the terms and conditions of the succession plan and also the valuation model that will be used. Where these terms can be agreed when no succession event is on hand, this normally allows the partners to reach an agreed position with no tensions around immediate interests.

It is also important to look at the age spread across the partnership. Unless you have a reasonable age spread with new partners coming on there will not be natural buyer group. The other key is to ensure that partnership performance is such that it will encourage partners to take up greater equity in the firm.

Managing partner retirement should normally be planned three to five years out from the succession event.

Buyout issues checklist

Issue to address	Comments	Date completed
1.Terms and conditions required on sale		
2. Existence of exit terms under existing partner/ shareholder agreement		
3. Valuation and price		
4. Apportionment of price and tax treatment of components		
5. Willingness to sign a restrictive covenant		
6. Willingness to accept any part of the settlement proceeds being deferred		
7. Willingness to accept a part of the consideration being contingent on future revenue performance of the practice		
8. Willingness to accept any claw-back provisions		
9. Will the retiring partner be retained under any type of consulting agreement?		
10. Is all work in progress to be billed out prior to settlement?		
11. Solicitor to be instructed to draft transfer agreement		
12. Removal from practice guarantees and indemnities		
13. Resignation from practice entities and registered business names		
14. Transfer of client base to remaining partners		
15. Advice to staff and clients		

Issue to address	Comments	Date completed
16. Advice to professional bodies		
17. Advise PI insurers		
18. Updating details on practice stationery and website		
19. Does change represent a reconstitution of the partnership for tax purposes?		

4. Valuation and pricing

Why value and price may be different

Value and price will not always equal each other. In a perfect market they should, but no sale operates in a perfect market. So don't expect your valuation and pricing to be the same.

Take a moment to think about the normal valuation introduction. It goes something like this: 'The fair market value is the price that would be negotiated in an open market between a knowledgeable, willing but not anxious buyer and a knowledgeable, willing but not anxious seller dealing at arm's length within a reasonable timeframe.' While true in establishing a fair market value, it is not reflective of the typical market in which a transaction takes place. In most cases either the seller or the buyer will be more anxious, willing or knowledgeable and this imbalance will influence the price.

It is not uncommon to see price to be at a premium or discount of up to 33 per cent of the valuation.

In determining a likely price for your firm, you would start with a valuation estimate of the firm and then overlay relevant market influences that are likely to push the price in excess of the valuation or alternately that depress the price against the valuation. Included in these factors will be supply and demand. This will not be the same across the entire market, so don't accept generalisations as applying to everyone.

As more practices come on to the market there will be a normal supply/demand pressure. However, it is more likely that what we will see is a polarisation on price rather than a similar effect with all firms. Good practices will continue to command their price while poor performing firms will be more difficult to sell and in some cases unsaleable. In sale events it is becoming increasingly common to include an element of the purchase price that is contingent on future performance. This serves as some level of protection for the purchaser against clients or work that may leave the practice on departure of the vendor. Typically this will be limited to the first anniversary of the sale date. The 'at risk' consideration may be tied to some deferred payment arrangement. Contingent consideration may also be used where the practice is in growth phase and the vendor wants to be rewarded for growth that has been achieved but which, at the time of sale, has not been realised in fees. These types of arrangements are commonly referred to as 'earn out' or 'claw back' clauses. They are often used as a bridge in agreeing price between the vendor and purchaser.

The following sections should assist you to understand the likely methodologies that will be applied, when they will be applied and factors you should consider in reconciling value and price.

As a starting point you need to consider the purpose of the valuation. For example, is it for an outright sale or the sale of a partnership interest. In the case of the sale of a partnership interest you always need to have regard for any underlying partnership or shareholder constituent documents where a valuation methodology has been agreed and forms part of the partnership or shareholder agreement.

Current practice valuation methodologies

There are numerous methods used in valuing a business. Traditional methods used in valuing a business include:

- capitalisation of future maintainable earnings
- discounted cash flows
- rule of thumb or industry method
- return on investment.

Ideally, you should have a level of understanding of each of these methods. In the valuation of SME businesses the most common method employed is the capitalisation of future maintainable earnings method, followed by the rule of thumb or industry multiplier method.

Capitalisation of future maintainable earnings

Capitalisation refers to the return on investment that is expected by an investor. This method forms an opinion on the business value based on the sustainable profits generated by the business relative to the risk return expected. While not precise, it allows an investor to consider possible future returns against other investment options.

This is the most widely used and accepted methodology in business valuations for small and medium businesses. As such, much of this section concentrates on the workings of this methodology.

It involves an analysis of the past performance of the business, in order to determine the business's future maintainable earnings and capitalise those earnings for an expected rate of return for the investment. See working paper - maintainable earnings calculation working paper.

The valuation expressed as a formula is:

Value = Future Maintainable Earnings / Capitalisation Rate

Procedure for valuation under capitalisation of future maintainable earnings

1. Obtain as a minimum the previous three years' financial statements of the business to be valued.
2. Review the financial statements and determine from enquiry and other means whether the financial statements adequately represent the trading of the business.
3. Analyse the profit and loss statements, making appropriate adjustments for either commercial and non-commercial expenses or income included in the accounts.
4. Total the net results for the years reviewed and calculate the average net result. This figure is referred to as the maintainable earnings amount.
5. Consider whether any permanent issues that were not necessarily present in the prior periods trading will affect the future year's profits.
6. Identify the industry in which the business trades and determine what would be an appropriate return for an investment in that industry taking account of the risks and other issues applicable to an investor.
7. Divide the maintainable earnings figure calculated in 4 above, by the desired investment return as determined in 6 above.
8. Analyse the latest balance sheet and calculate the value of the net tangible assets of the business assets.
9. Subtract the net tangible assets from the value calculated in 7 above; the net result is the value of the goodwill of the business.

Establishing the maintainable earnings

When analysing the profit and loss statements there are a number of factors that should be considered in establishing a future maintainable earnings figure:

- the comparison should be made over a period of at least three years
- an allowance should be made to include a commercial salary for the owners
- adjustment should be made for any above or below market salaries or benefits paid to the owners or their associates
- adjustments should be made to exclude any costs, which do not relate specifically to the operation of the business
- depreciation or amortisation charged for prior years should be amended to reflect accounting rates for life of equipment and not tax rates
- interest should be excluded from the calculation, since that reflects a funding decision of the vendor, not the purchaser. Obviously, a purchaser would need to include his own estimates to determine his rate of return
- if real property is included in the sale, a commercial rent should be included in the operating costs and the property valued separately.

- the maintainable earnings figure can be calculated on either a pre- or post-tax basis. However, you must ensure that the applicable capitalisation rate is based on the same tax basis.

Once you have calculated the adjusted earnings for each of the three years (or a greater period being reviewed) you then need to average the earnings to determine a future maintainable position. You may either apply a simple average or alternatively, a weighted average with the higher weighting applying to the more current years. The decision to use a simple average or a weighted average may be influenced by the degree of variability in earnings over the period being assessed.

Where you are valuing a business part way through a year it may be appropriate to include the current year position, particularly if there are clear trends developing through the year. Where you are using a weighted average approach you will need to consider if some level of discounting is appropriate to reflect the lack of certainty in the final result. In a limited number of cases it can be appropriate to include a future year in your consideration. Such a case could exist where forward income is locked in and there it has a material effect on the result. In this you need to consider the level of certainty around the earnings forecast. This requires an assessment of both the reliability of income and expense forecasts.

Capitalisation rate

Determining a capitalisation rate for the calculation is a subjective decision and again requires consideration of a number of factors.

The capitalisation rate effectively relies on the concept of 'fair value' and requires the valuer to establish what a willing and informed purchaser would require from that type of investment. In determining the rate, it is necessary to consider a number of factors:

- current 'risk free' rate of return, usually the government bond rates
- relative bank rates of interest, comparing say cash rates to bank bill rates
- price earning ratios of publicly listed stocks, comparing differences between:
  - blue chip industrial type shares
  - smaller industrial stocks
  - various same industry stocks.
- ability to resell the business – liquidity of the asset
- identify risks particular to the relevant industry
- identify risks specific to the business being considered
- length of time that the business has been operating
- effect of technology on the industry and business - will major investments be continually required?
- is the industry still growing or has it matured or even declining?
- is the business subject to any issues due to its location?
- level of business dependence on key customers, suppliers or staff
- are there any regulation changes likely that will affect the business?

The rate can be determined by a number of approaches. One such approach could include:

- 1. start with a risk free rate or the industry adjusted P/E multiple
- 2. list the issues identified affecting the investment decision against a scale applying a percentage multiple to either increase or decrease the rate
- 3. tally the scores to either add or reduce the initial figure.

The valuer may then, even after adopting such a methodical approach to weight the different issues, simply adjust that for their own experience of similar businesses operating in that industry. The majority of accounting firms will command a multiple in the range of 3.4 to 4.2 times earnings.

Finally, the rate also needs to be determined on a consistent tax basis to how maintainable earnings was calculated, that is on either a pre- or post-tax basis.

Calculating the value

Based on the formula set out previously, the valuation is then simply determined by dividing the maintainable earnings, by the capitalisation rate. Where the capitalisation rate is expressed as a multiple you would apply this multiple to the assessed future maintainable earnings.

When providing an amount, we suggest you establish a range as opposed to simply quoting a spot price. This can be achieved by using an upper and lower capitalisation rate for the calculation. Similarly, you may choose to establish an upper and lower earnings estimate.

Remember, the calculation made is for the gross value of the business. To the extent that any assets exist within the business that are surplus to the requirements of the business, then the value assessed would be increased to allow for these surplus assets. You should always consider and comment on the existence of surplus assets.

Rule of thumb or industry multiplier method

This approach adopts the value of the business as relative to an 'industry standard'. Generally, the multiplier would be applied to either the profit of the business or its turnover. For example:

- Accounting practices may apply so many cents in the dollar of gross fees

The most common rate occurring in the current market is in the range of 80 cents in the dollar of maintainable fees. There are examples of transactions falling above or below this range. It all depends on the fundamentals of the practice. Practices exhibiting high profitability, good quality clients and strong growth features are the ones most likely to command strong pricing. Location will also have an impact on this. Areas where there are a large number of firms and where there is continuing demand for accounting firms will command the best rates. Some isolated locations may trade at a discount.

Where a practice has a financial planning revenue stream within the practice, it would be normal for this to be valued separately. This assumes that the revenue stream is material. This normally occurs where revenues exceed $100K.

The problem with adopting these industry standards is that they are really only applicable to those businesses that operate to an industry average. The multipliers offer no benefit or discount for those businesses that are either above or below the standard. Where you are using this method and providing a professional opinion you should consider and where appropriate comment on this.

Also, in applying a standard industry method, the price should be compared to an alternative methodology to ensure the merits of the business investment. For a purchaser, it may be necessary to borrow or invest funds, and accordingly it is essential that profits can be earned, and the investment is capable of being recouped.

Other methods - return on investment (ROI)

This method considers the return that will be achieved by the investment. It measures the maintainable revenues of the business against the investment required. Unless you have threshold levels below which you would not invest in a business, this method provides a comparative rather than an absolute valuation.

It is not unusual to use ROI as a secondary valuation method. While there are no absolutes you would normally expect the ROI to be in the range of 20-50 per cent. A return less than 20 per cent would normally not warrant the risk of an investment in a private business. This method requires an analysis of the risk /return model of any business.

Also, in applying a standard industry method, the price should be compared to an alternative methodology to ensure the merits of the business investment. For a purchaser, it may be necessary to borrow or invest funds, and accordingly it is essential that profits can be earned, and the investment is capable of being recouped.

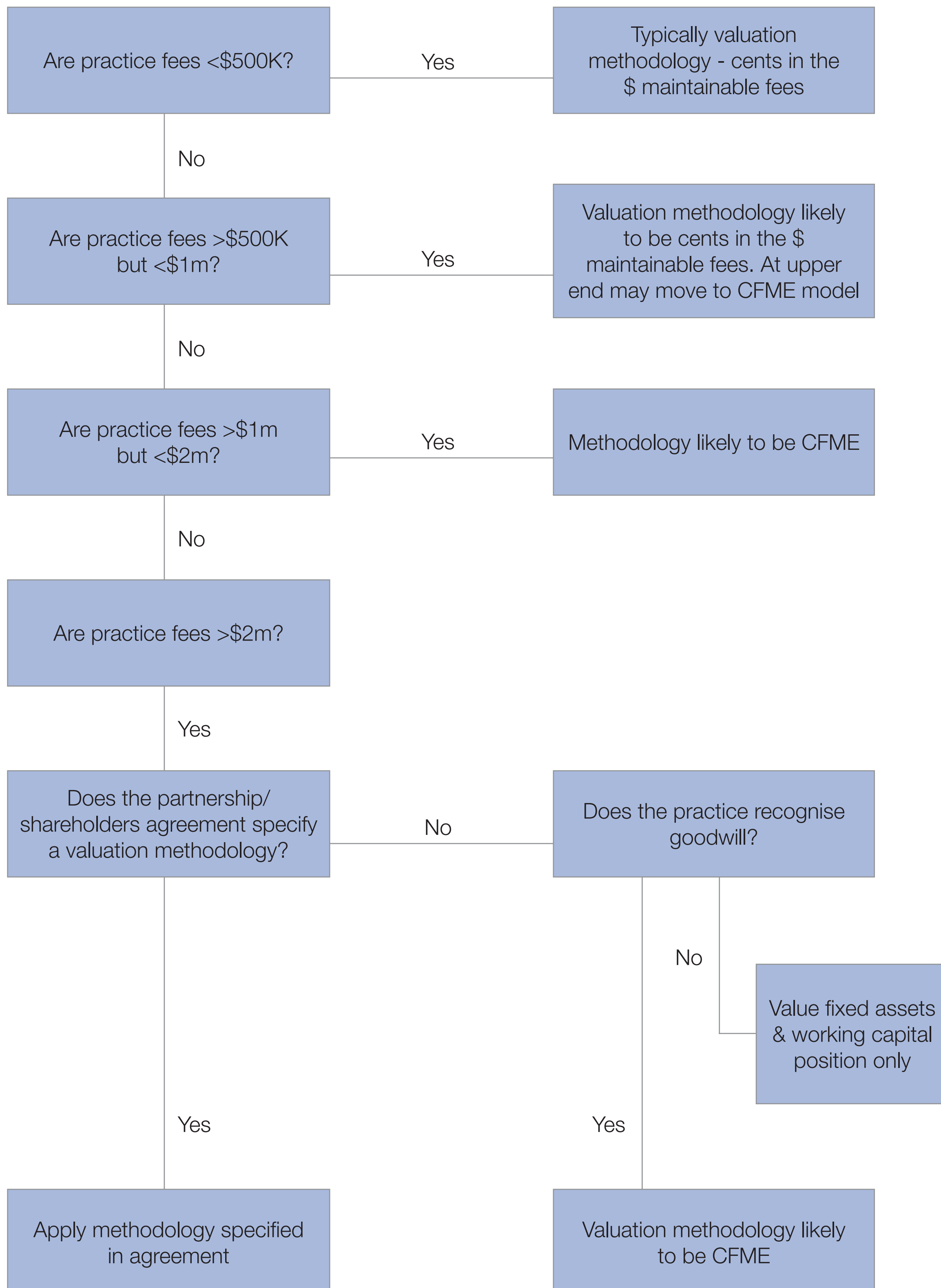
Valuation segmentation

There is a reasonably clear segmentation of valuation methodologies that is based on the fee level of the practice. Like any segmentation it is not absolute and will blur somewhat when you approach the dividing lines. As such the following should be taken as an indicator rather than as an absolute.

The annual fee levels across the accounting profession can be divided into the following natural segments:

Less than 500k	In the majority of cases practices or fee parcels of this size will be negotiated on a cents in the dollar of maintainable revenues. Currently there is a reasonable demand for practices of this type. If the practice is a good quality one and exhibits reasonable levels of profitability it will command pricing at the upper end of the price range.
$500k to $1m	In the majority of cases price will still be negotiated on a cents in the dollar of maintainable revenues. The closer the fees to the $1m range the greater the focus will be on the profitability of the practice. Your buyer will be more concerned about the rate of profit after allowance for principal or partner salaries. In some cases at the upper end of this fee range you may find buyers who want to employ more traditional valuation methodologies to establish pricing such as a capitalisation of future maintainable earnings.
$1m - $2m	As the size of your practice moves above annual fees of $1m it is far more likely that the practice will be valued for pricing purposes using a traditional valuation methodology. The most common valuation method currently employed is a capitalisation of future maintainable earnings. This requires establishing a maintainable earnings level for the firm. The earnings will normally be adjusted for any abnormal items and in particular salaries for principals and partners will be adjusted to market levels. The earnings level being established is after reasonable principals' and partners' remuneration. This methodology has a very strong focus around the levels of profit being generated by the firm. Once the maintainable earnings level has been established it is then necessary to determine an appropriate capitalisation rate for the firm. Where the firm has quite different types of revenue streams such as business services, financial planning and insolvency then the firm will not be valued on a single revenue stream basis. Different revenue streams characteristics will be valued separately.
> $2m	Practices of this size will almost certainly be valued for pricing purposes using a traditional valuation methodology. The most common valuation method currently employed is a capitalisation of future maintainable earnings. This requires establishing a maintainable earnings level for the firm. The earnings will normally be adjusted for any abnormal items and in particular salaries for principals and partners will be adjusted to market levels. The earnings level being established is after reasonable principals' and partners' remuneration. This methodology has a very strong focus around the levels of profit being generated by the firm. Once the maintainable earnings level has been established it is then necessary to determine an appropriate capitalisation rate for the firm. Where the firm has quite different types of revenue streams such as business services, financial planning and insolvency then the firm will not be valued on a single revenue stream basis. Different revenue streams characteristics will be valued separately. It should be noted that some large firms do not recognise goodwill as this is seen as an impediment to the progression of younger partners where a large goodwill payment may be difficult. Firms of this type require incoming partners to make a contribution toward working capital and when they leave their payout is only for working capital. Sales to such firms could lead to different views in relation to goodwill recognition. Such cases would be in the minority.

Flowchart to selecting a valuation model



Valuation template working paper

Where you are completing a valuation using a capitalisation of future maintainable earnings methodology, the following working paper may assist in calculating the maintainable earnings.

Prepared by:
Reviewed by:
Date:

Practice:

Date:

	2010	2009	2008	2007	2006
Net profit before tax, per financial statements					
Add backs:					
Interest					
Wages drawn by principals					
Other benefits drawn by principals:					
Excess motor vehicle expenses					
Travel claims					
Other					
Depreciation charged (tax)					
Other expenses not applicable to Operations					
Less:					
Commercial wages for principal					
Depreciation charge (book values)					
Adjustments for commercial lease costs					
Base					
Outgoings					
Other items to deduct					
Add/(Less): permanent adjustments					
Total net adjusted profits					
Total net adjusted profits for years reviewed	0				
Average maintainable earnings	**0**				

Where you are using a cents in the dollar of maintainable revenue approach the following working paper may assist your calculation.

Prepared by:
Reviewed by:
Date:

Practice:

Date:

	2010	2009	2008	2007
Gross fees per financial statements				
Adjust for:				
1. Material clients lost				
2. Non recurring work undertaken				
3. Abnormal client work				
Adjusted gross fees				
Based on the fee trend calculate:				
1. A simple average				
2. A weighted average				
Maintainable annual fee level estimate $				

Working paper to assess price against valuation

Practice: Date:

Nature of Asset: e.g. practice, fee parcel, partnership interest

Price $

Valuation $

Price premium/discount $

Factors that may lead to:

Discount		Premium	
1 Revenues trending backwards	☐	1 Strong revenue growth trends	☐
2 Evidence of loss of material fees	☐	2 Recent major client acquisition where fees not fully realised.	☐
3 High volume, low profit work	☐	3 Good quality work and clients dominate practice	☐
4 Low practice profitability	☐	4 High practice profitability	☐
5 Reasonable quantity of similar practices on the market	☐	5 Scarce supply of similar practices	☐
6 No restrictive covenants or non compete agreements	☐	6 Major new work identified and committed	☐
7 Material clients approaching retirement or succession events	☐	7 High quality work papers and strong systems	☐
8 Practice client sensitive i.e. major clients in excess of 5% of practice revenue	☐	8 Claw-back or earnings contingency provisions allowed	☐
9 Higher risk profile of client base	☐		
10 Low quality work papers and systems	☐		
11 No claw-back provisions allowed	☐		

Checklist of pricing considerations

Issue	Completed/comments
1. All assets included in the price have been identified	
2. Price has been apportioned across asset classes, with appropriate recognition of work in progress where it exists	
3. Prices for comparable sales have been identified and assessed	
4. Is any of the price contingency based?	
5. Does the price include any allowance for transition assistance?	

Pricing goodwill, plant and equipment, and working capital

Once you have established a final sale price it is important to consider the apportionment of the sale price. Typically the focus at the time of the sale is on achieving the sale and the global price for all of the assets. It is not uncommon to see sale agreements where the sale price is not apportioned. This can lead to later problems and outcomes that you may not have expected. In particular you need to consider how your sales proceeds will be treated for tax purposes. You may see your sale as primarily being the sale of a capital asset, and whilst this may be true it is likely that there may be a mix of capital and revenue assets being sold. The area likely to cause the most impact is the position on work in progress.

Where the consideration or part of the consideration is deemed to be a payment in respect of unbilled work in progress then this amount will be on revenue account and assessable under s. 15-50 ITAA 1997. A number of cases have been decided on this point in relation to professional practices and including *Crommelin v FCT* (1998) and *Stapelton v FCT* (1989). Where the contract has no apportionment or where the apportionment does not recognise the position of work in progress then the commissioner has the ability to reconstruct the apportionment of the consideration.

Where the consideration is on capital account and is in respect of the disposal of capital assets being an interest in the partnership assets, the consideration will be subject to the capital gains tax provisions. Section 106-5 deals with partnerships, and the acquisition or disposal of a partnership interest. The commissioner further states his view on this in IT2540. In brief the commissioner adopts a fractional approach to partnership interests. This accommodates not only individual partner shares in a single asset or assets but also accommodates situations where a partner may acquire interests in the partnership at different times.

All of this highlights the importance of some forward planning and identifying the likely tax impacts flowing from a sale of your practice or an interest in the practice.

5. Implementation and timing

Your succession plan checklist

The following table provides a step by step implementation process.

Succession step	Objective	Outcome
1. Initial review	Discuss succession requirements and approaches.	To agree an approach going forward.
2. Review succession options	Consider the options available and their relative merits.	To have canvassed the options and agreed the most suitable option to pursue.
3. Undertake a practice diagnostic	Achieve a greater understanding of the practice including: • financial indicators • non financial factors • risk issues • opportunities • areas for value enhancement	Completed practice diagnostic report, including documentation of recommendations for areas that need to be addressed or focused on for improvement. This is the 'getting the practice ready for succession' roadmap.
4. Valuation	Establish a valuation on the practice at its current position and relative to the market.	To establish a valuation and to provide a 'stake in the ground' on business value to test against your perception or expectation of business worth.
5. Succession timetable	Prepare a succession timetable.	To agree a timetable both for the timeframe to final outcome and the timing for the various steps.
6. Develop succession plan	Document a succession plan matching the steps required under the succession objective, detailing work to be undertaken, allocation of responsibility, outcomes required, and time for completion.	To agree a detailed succession plan program.
7. Undertake practice improvement program	Put in place a program and address areas where practice value could be enhanced. This will include a focus on: • profitability improvement • growth development • systems development • risk management processes • organisational structure and documentation	Areas raised in the practice diagnostic will be addressed where possible and business value will be enhanced in preparation for a sale/transition.
8. Balance sheet review	Undertake a review of the balance sheet with view to putting in place any adjustments, restructuring or alignment of assets & liabilities necessary in preparation for a transition of the business.	To have no impediments in the balance sheet or business structure that would inhibit or adversely impact a transition.

Succession step	Objective	Outcome
9. Taxation review	Consider the taxation position of the practice and the taxation impact of a sale and with consideration for the eligibility to the CGT small business concessions.	To seek to maximise the tax position for the client and to consider the structuring that would create greater taxation efficiency.
10. Financial reporting structure	Ensure that the practice has financial and operational reporting adequate to present the business history and trends over a 3-5 year timeframe.	The ready availability of financial and business information to present to potential buyers of the practice, to assist them in understanding the performance.
11. Pre sale internal due diligence	In the period 12 months prior to sale/ transition complete an internal due diligence on the practice to ensure that there will be no surprises during the sale process.	To identify any risk positions within the practice that may influence/inhibit the sale process.
12. Establish sale/ transition terms	Agree the sale issues including: • sale structure e.g. sale of assets, sale of shares, sale of equity interest • sale price • financing requirements • warranties & indemnities available • restraint conditions • vendor support period • control issues/shareholder agreements in transition or equity interest sales • other vendor requirements	To have established prior to the marketing of the business the requirements of the vendors and consideration of any issues that are likely to arise in contract negotiation.
13. Valuation test	Review current valuation against sale price expectation.	To agree the reasonableness of the expected sale price.
14. Establish marketing plan for the business sale/transition	Agree the marketing approach and timetable for the business sale/ transition. This would include the appointment of an intermediary or broker where necessary.	To have clear alignment with expectations on marketing plan, cost and expected timetable.
15. Preparation of information memorandum	Prepare a current IM on the practice that is available to potential purchasers and facilitates a cascade of information throughout the sale/ transition period.	The ready availability of an information package on the practice to respond to initial enquiry.

Succession step	Objective	Outcome
16. Agreement on other external advisers	Have in place any external advisers necessary to the sale transition process, with appointments and terms agreed.	All advisors required for the sale/transition process instructed and ready to act as required.
17. Put the business into the market	Commence the active marketing program of the business where necessary.	To establish the interested parties in the business for negotiation purposes.
18. Enquiry management and filter	Manage enquiries down to a smaller group wanting to move to negotiation stage.	To create a short list of serious candidates for purchase of the business.
19. Contract and due diligence	Manage contract negotiations to a heads of agreement and to complete the due diligence where required.	To bring the final purchaser(s) to a point of sale/transition completion.
20. Settlement	To assist in final settlement of the sale/transition.	To achieve completion.
21. Manage post settlement issues	To identify and review any financial, business or taxation issues that need to be addressed as a consequence of the sale/transition.	To finalise all issues relevant to the business and consequent of the sale/transition.

Issues to consider in going to the market

Timing

There is no such thing as the ideal time to go to the market. There are, however, three fundamental rules that apply.

Rule 1

If you can avoid it, don't lock yourself into a fixed date to exit your practice. Normally it can be quite difficult to engineer your succession to an exact date. It is better to work with a time window. This window may stretch across a year or two and you should be prepared to proceed with your succession if the right opportunity presents itself. This means keep some flexibility in your thinking and planning. It also means being succession ready at any time during this window period. This is another reason why the planning process is so important.

Locking in to fixed dates may put undue pressure on you or may cause you to accept an offer that is less than what otherwise could be had. One of the big dangers in locking into a fixed date is that as this date approaches you have already psychologically 'left' the practice. This can mean that your focus drops off and practice performance suffers. At the time of a succession event, this is when you want your practice at peak performance. You want to put the best possible appearance to the market. Potential buyers or partners will sense a lack of focus. It can derail an opportunity or impact pricing.

Rule 2

The best time to initiate your succession event is when an offer presents itself. Sometimes the bird in the hand needs to be taken. If you are in succession mode and someone comes to you with an offer, don't discount it simply because the timing isn't ideal. Consider the offer when it is put. Don't take it simply because it is the first offer to come along, but don't reject it simply because it is unexpected. If the offer is a reasonable one, then it should be seriously considered.

In any succession event there is an element of chance. And part of that chance is being in the market at the right time. You won't always be able to choose your timing, but you will always have the choice as to how you respond to unexpected offers.

Rule 3

Historically more practices sell or merge in the first half of the year than the second half.

The majority of practices in Australia are business services firms. They are dominated by accounting and tax compliance work. Once July 1 rolls around each year, the focus is on production and the first six months is very compliance dominated. Succession events can occur at any time. However, sales and mergers tend to occur more in the January to June period than later in the year.

Contracts and agreements

It is always advisable to have draft contracts or agreements prepared in advance of going to the market. Once you are in the market and receiving enquiries you don't want the process delayed while you are waiting for agreements to be drafted. You also improve your negotiating position by establishing the starting position, rather than everyone starting with a blank sheet of paper.

Depending on the nature of your succession event you may require:

- sale agreement
- merger agreement
- partnership deed, or
- shareholders' agreement

In having a draft agreement prepared you can include your preferred terms and you can have warranties and indemnities drafted which are reasonable but not onerous. This allows you to present them to the interested parties, once you have agreed a position in principle, and negotiations have reached the appropriate stage.

Once you have identified when you are going to the market, you should identify the main terms and conditions of the proposed succession event and then meet with a solicitor who is experienced in drafting commercial agreements. It is

always advisable to use someone who is experienced in this area. Like accountants, solicitors specialise in different areas of practice. The fact that a solicitor is great at conveyancing, or estate work does not automatically mean they are experienced in commercial agreements. It's horses for courses.

An experienced solicitor should be able to take you through the typical clauses that would be expected in a sale, merger or shareholders' agreement and explain their effect.

It is not uncommon that professionals get tied down in the detail. You may find that you can agree broad terms fairly easily but it is when you get into the finer detail that differences can appear. Working through this finer detail in draft agreements will better prepare you for what may be coming and allow you time to think about your position on different issues.

Partnership or shareholder agreements will cover the broad relationship between the parties to the agreement. Much of what is included could be regarded as good common sense. Where these agreements are being put in place you should consider how the position will be managed in the event of a dispute or the exit of a partner. Disputes and exit provisions are normally the most contentious issues when they occur. At the time the parties may be in conflict or very much focused on self-interest. This can lead to an escalation of the dispute and a lot of time, energy and money caught up in legal fees and managing the differences. The best time to agree on dispute resolution procedures or exit provisions is when there is no event on foot. Having clear provisions within your agreement may involve a bit of thinking and discussion, but it will save an enormous amount of time and energy in years to come.

It is a fact of life that everyone entering a partnership or buying shares in an entity will one day leave. Exit provisions should consider circumstances, leading to a partner leaving the firm, including:

- death
- illness or permanent disability
- retirement
- resignation.

Your exit terms don't have to be the same in each situation. You should consider including in your agreement, notice periods required, valuation methodologies to be employed, and any time period for payout of partner interests.

Where a sale is involved make sure that your agreement is clear on the assets being transferred, how work in progress and debtors are being dealt with. You should also consider the position on the collection of debts, as it is quite likely that continuing clients may pay their fees into the 'new firm'. This will then involve you collecting these funds from the purchasers. This is not uncommon, but terms and requirements should be included in your sale agreement.

Warranties and indemnities

This is an area to consider well in advance. Virtually all sale contracts and most other agreements will include warranties and indemnities. Typically these have the greatest impact on the vendor. You need to be absolutely certain on what you are warranting and the level of indemnities being provided. This is also another reason why it may be beneficial to have your agreements drafted in advance of going to the market. This way you take the lead in drafting warranties and indemnities that you are prepared to accept.

Your solicitor should be able to advise you on both warranties that are typical in sale contracts and examples of more onerous warranties that you should avoid. The purchasers or their advisers may seek to have extensive warranties included in the contract, to build in as much protection as is possible for the purchaser. It would be normal that the warranties sought on a sale of equity would be more extensive than the warranties on a sale of business assets. This is because a sale of equity transfers to the purchaser any contingent liabilities that may be resident in the corporate entity. Irrespective of this it is arguable that any major liability on the practice will impact the value of practice goodwill.

While it is quite normal to provide a level of warranties and indemnities, the general rule should be:

1. seek to limit the warranties being provided
2. don't warrant anything that you cannot control

3. where a warranty is given, try to limit the value of the indemnity being provided

4. place a time limit on your warranty and indemnity.

Often it is the wording of the warranty that makes all of the difference. As an example, a warranty that says 'that you are not aware of any contingent liabilities on the practice that have not been disclosed' may be reasonable whereas a warranty that says 'there are no contingent liabilities on the practice' could be quite unreasonable because you cannot reasonably warrant what you don't know.

And this is where a good commercial solicitor is invaluable. In your contract or agreement the warranties often come well into the agreement and may not be considered as a big issue. It is easy to consign them to 'oh, that is just the legal stuff', but it is these warranties that can cause a lot of problems after the succession event. If a matter ends up in dispute, then it is the warranties that the solicitors will be looking at closely.

Prior to going to the market you should have considered the warranty and indemnity issue, know what you are prepared to accept and what you won't, and have discussed this with your legal advisers so that you understand the implications of any undertaking you are prepared to make.

Non-compete expectations

If you are selling a practice, parcel of fees or undertaking a merger, it would be common to have non-compete clauses included in your contract or agreement. Typically these non-compete provisions will cover a period of time and a radius from the location of the practice where the vendor party agrees not to compete with the practice on a direct or indirect basis. Normally they would also include a provision that the vendor will not approach or seek business from an existing client of the firm, for a specified time period. This is designed to protect the value of the goodwill of the firm.

Non-compete clauses drafted in an agreement may be on a cascading basis. By this we mean they will start by providing a non-compete time period and distance for a longer period of time e.g. three years and then progressively provide in the alternate a reduced time period, often reducing by increments of six months. This type of clause is designed to allow for the interpretation of the courts. Under Trade Practices a court will generally not uphold a restriction on a person undertaking their trade or profession which is considered unreasonable. At the same time where that person has received a payment for their goodwill, a court will recognise and protect a purchaser and the terms of their agreement. Currently it would be normal for non-compete agreements for periods of one to up to two years to be enforceable.

In asking for or agreeing to a non-compete clause it is again important to be fully aware of what you are committing to.

Financing considerations

Ideally vendors and purchasers will not be linked to each other under financing arrangements. These simply add another level of complexity to any succession event, and extend the commercial relationship between the parties for the period of any financing arrangement. Having said this it is also not uncommon for a vendor to provide some level of finance support. Examples of this include:

- deferred settlement arrangements where part of the consideration is paid at future time periods (particularly across the first year after sale) or on reaching certain milestone events e.g. fee levels
- internal finance provided by a partnership, whereby an incoming partner's equity is partially funded out of their future profit share
- external finance supported by the equity of the firm to provide an incoming partner's equity contribution with repayment of the loan notionally being provided out of the partner's profit share.

It is essential that the terms of all financing arrangements are fully documented and agreed between the parties. Never enter into financing arrangements where the transaction could be left open to interpretation. Ideally financing arrangements should be short-term facilities which can be completed within three years. Where funding is coming from partnership profits be sure that the firm will generate sufficient profit to meet the funding arrangement in addition to normal capital and working capital requirements.

Where you are selling a practice and have agreed to provide some level of vendor finance there should be clear terms in respect of any default by the purchaser. To the extent possible these terms should be punitive, so as to encourage the purchaser to meet their financing obligations. In any sale of practice situation you would normally expect a purchaser to pay a minimum of 50 per cent of the agreed sale proceeds at the time of settlement of the contract. The greater the amount of the proceeds that can be agreed to be paid up front the better. Deferred settlements should only be offered as a last resort in the negotiation process. The reality is that the sale is not made until the money is in the bank. Where any form of deferred settlement is provided you should consider holding a bill of sale over the practice or other acceptable form of security.

Be aware too of the tax treatment of any form of deferred consideration. Typically the CGT event occurs at the time of contract and your tax obligations will trigger then, irrespective of any financing arrangements you have entered into.

Marketing options

When you are ready to go to the market there are a range of marketing options to select from. There is no one right answer here. It will depend on the circumstances and the succession option that you are engaging. Transactions within a firm would normally be dealt with by the partners, without the involvement of an external party. On some occasions an external facilitator may be involved. Transactions outside of the practice e.g. sale of a practice are more likely to involve an external party.

In deciding how you will proceed it is always a good idea to identify what your expectations are. This may help to resolve in your own thinking whether or not you need an external party involved.

Typically your expectations may include:

- identifying a ready market or candidates
- managing initial enquiries to bring out the serious prospects
- maintaining your anonymity during the early stages of the process
- having an intermediary to manage negotiations
- saving yourself the time and energy necessary to manage your succession.

All of these expectations are reasonable. However, they will not apply in all cases. Once you have identified what you are after, you will be better placed to decide on the best means of going to the market. Let's have a look at some of your options.

Utilising a broker

You could consider using a traditional business broker. There are a number of these. Normally unless they specialise in broking accounting firms they will not have the level of market understanding or ready access to a market of potential buyers. There are a small number of companies who specialise in the broking of professional practices. They typically operate in each state and a few operate across states. You can often identify these by their advertising in the professional journal. In addition you may receive direct advertising from them, from time to time.

Specialist brokers will normally understand the profession, its expectations and the current state of the market. In addition, if they are active and successful in their work, they should have an existing pool of interested prospects and they may have acted in comparable transactions over the past year. It's always a good idea to discuss with a broker what transactions they have completed in the past year, and where possible obtain some recent references from vendors they have acted for.

Fees with a broker are negotiable. However, fees in the range of five to 10 per cent of the sale proceeds are not uncommon. Don't be afraid to negotiate the terms. You may want to have a level of performance payment included i.e. a certain commission level where they achieve an agreed price, but reducing to a lower level where price is negotiated below your agreed listing price.

You need to decide whether they can provide what you are after, the level of confidence you have in their ability to represent your interests, the extent of the market they have access to, and whether their cost represents good value to you. If you are considering using a broker then take the time to understand their process of taking your practice to the market. They

should have a process, and the absence of one may signal a more hit and miss approach. There should be a clear process in identifying what information the market will require, how the information will be packaged, the marketing stages they will employ and how enquiries and negotiations will be managed.

In engaging a broker you should have a clear understanding on the following areas:

- whether their agency is exclusive or not
- the terms of their agency
- the basis under which you can terminate the agreement
- broking fees payable
- other costs that you may be liable for e.g. advertising
- the level of disclosure they are able to make
- whether or not you require confidentiality agreements completed prior to disclosure
- what happens in the event that a sale is made after conclusion of their agency agreement or to a party they have not introduced to you.

Prior to the appointment of a broker it is a good idea to have all of these areas agreed in writing.

Normally where a broker is engaged this would most commonly occur for a sale of practice, sale of fee parcel or merger.

Acting for yourself

This alternative will work for some people and some succession events lend themselves to it. Increasingly in sales, mergers and partnership changes the parties are known to each other. Depending on the extent of your professional network you may be able to identify a ready pool of candidates or interested parties. If this is the case the two primary considerations are your comfort zone in acting for yourself and also whether you have the time to devote to pursuing the prospects and then working through the negotiation stages.

If you are acting for yourself then it is likely that you will be making direct approaches to other professionals that you already know. In doing this there are some good guidelines to follow.

1. Be clear about what you are seeking to achieve. Better to be straight up than hoping someone will pick up your drift.
2. Understand the information that interested prospects will be after.
3. Be prepared – once you initiate discussions, to have follow on information available that you will be able to provide.
4. Have some level of understanding where the market is up to.
5. Be reasonable in your expectations. Don't ask for things that are way outside of the market and which are not supportable.
6. Be commercial. You are looking to achieve a result. Both parties will need to be satisfied with the deal. It can't be a win/lose situation.
7. Establish clear timeframes. Better off to close out a discussion than to have it continue aimlessly. Once parties agree they want to proceed with discussions it can be helpful to set some timeframes for decision points. Sixty days is not unreasonable.

Where succession arrangements are internal to the firm it may be a good idea to appoint one or two people to manage the process. Dealing with the detail of these in broader partnership meetings will often lose focus or get bogged down in detail that can derail the process. Better to have a small group leading the process.

Using an intermediary

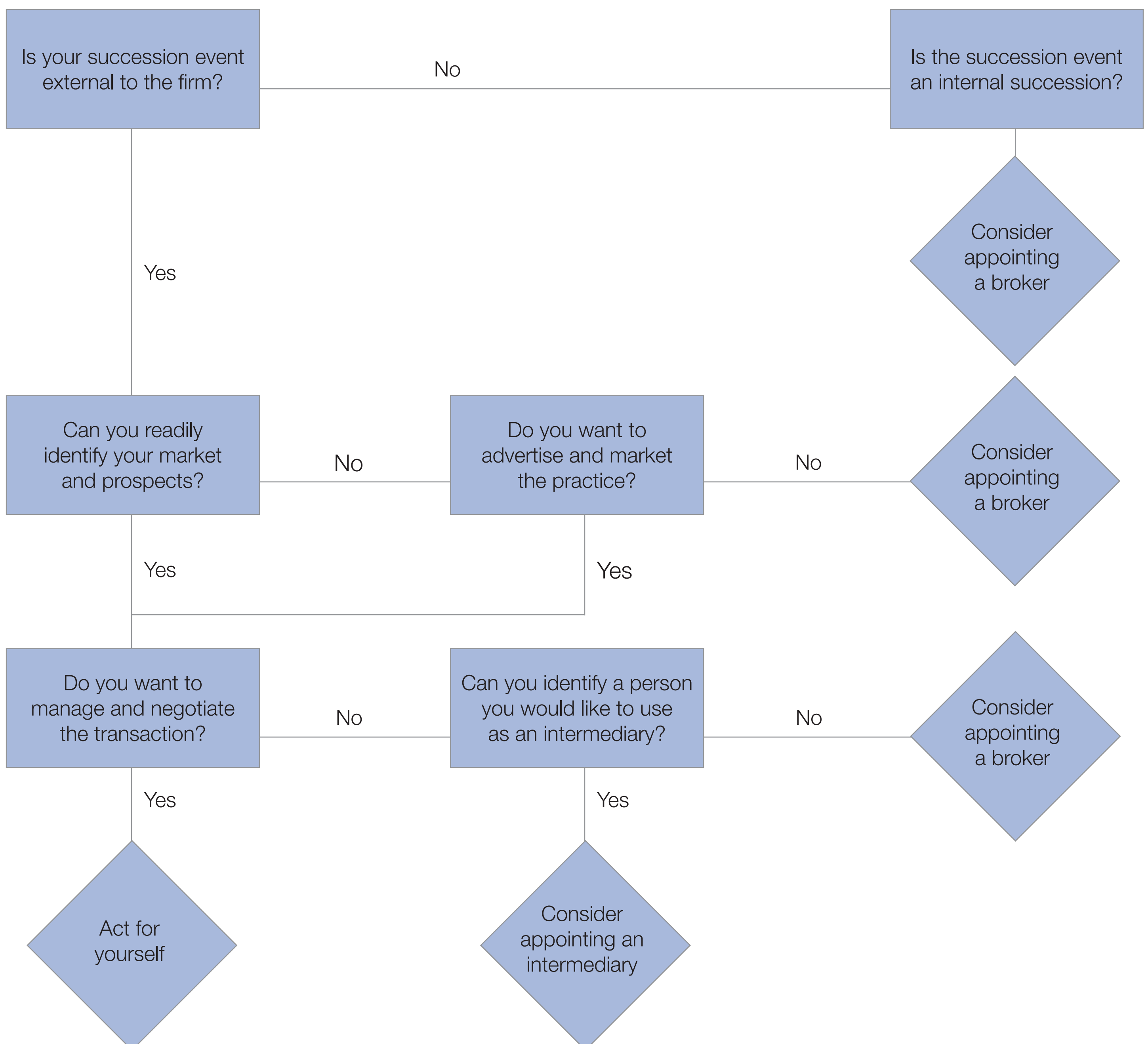
This option would more likely be used where you are able to identify your likely market and prospects but where you feel you would like to have someone else negotiate the actual deal. For some people this is a time issue, for others it is a view that they are too close to the transaction and unlikely to manage it effectively.

In using an intermediary you are looking for someone who you trust, who is likely to be respected and engender trust by the other party, who is aware of the market you are in and is a good commercial negotiator. Sounds like a tall order but these people do exist. They aren't necessarily doing this type of work full-time, but are skilled in representing people and negotiating deals. They may be another practitioner or other professional.

The keys to using an intermediary is to provide them with clear instructions, agree with them what they are authorised to commit to and the frequency of being updated on their progress. Normally the cost of an intermediary would be less than the cost of a broker.

Flowchart to selecting your marketing approach

The following flowchart may assist you in your decision process. In references to internal and external succession we regard external succession events to include sale of practice, sale of a parcel of fees and mergers as external succession events.



Information memorandum

Where your succession option is a sale of practice or merger, you may want to prepare an information memorandum on the practice.

The objective of the information memorandum is to provide a concise and accurate statement regarding the market, financial and operational status of the practice and to allow for a cascading of information to potential buyers.

This document must be regarded as the key document in the entire information supply process. The information memorandum needs to fairly represent the practice and to seek to favourably position it in the eyes of interested parties receiving it. The purpose of the information memorandum is to provide a high level overview of the practice. Having read this document a potential buyer should have a reasonable understanding of the practice. The information within the document needs to be logically ordered and succinct in its message. Descriptions of business issues should be brief, factual and to the point. A positive aspect on all relevant issues should be the objective.

In any sale situation a tension will always exist on the amount of information that should be released to an interested party. The tension moves between the desire to provide a potential buyer with the information necessary to proceed, against an equal desire to avoid disclosing commercially sensitive information on the practice to a party who may not be genuine. By providing a high level view of the business through the information memorandum, you create an opportunity to weed out the casual enquiries. Detailed financial information should never be included in an information memorandum. High level financial data should be adequate in the initial enquiry stage.

The document needs to represent a factual summary of the following sections:

- executive summary – provides an outline of the core practice operations, recent successes and exhibits the key financial performance indicators, if possible for three consecutive years
- a concise list of assets for sale
- an indicative sale price, with consideration allocated between plant and equipment, office furniture and equipment and goodwill (business name and reputation, customer lists etc.)
- practice background and philosophy with identification of future plans
- revenue analysis, with revenue by larger clients (typically in bands of 5 or 10)
- employees and organisation chart with key roles identified
- description of the premises and appropriate financial details (lease terms, rent etc.)
- a high level financial overview with trends over a three to five-year period including gross revenue, key expenses and net profit before partner/principal remuneration.

The layout should be logically organised, easy to read and glean key information.

Information memorandum elements

(i) Executive summary

The executive summary should effectively and concisely summarise on **one page** the following details

- a general description of the practice, its location and the service areas which generate the revenue
- a statement concerning the market in which the practice operates and its perceived position in that market
- a description of the core or predominant client base and mention of the majority source of revenue
- a table depicting the key performance indicators for the previous three years, with any footnote regarding performance anomalies.

(ii) List of assets for sale

A brief list stating the entire business assets available as part of the business purchase.

(iii) Indicative sale price with an apportionment of the price against the various asset classes

(iv) Background

A description of the practice activities starting from the establishment date of the current owner. Where the practice was under prior ownership, it may be worthwhile to provide some additional history.

This text should cover important milestones in the history, along with key decisions which have influenced the performance and existing reputation of the practice.

Comments regarding major clients (without client disclosure), significant marketing and commercial events and performance highlights of note should be included.

(v) Practice philosophy

The theme in this section should seek to explain the logic behind some of the major commercial decisions that have been made over the ownership period and the outcomes, desirable or otherwise of those decisions.

An interested party reading this document should be able to understand why the practice presents as it does and to consider how the practice could be changed or improved with a new set objectives and targets.

The business philosophy or drivers generally shape the performance to suit the direction and performance desired.

(vi) Clients

This section provides an opportunity to quantify the impact of either the top group of clients on practice revenue and profitability, or it should explain target client profile.

You would normally identify the top five to ten clients or in some level of banding. At this stage you would not disclose client names but rather identify them by number or possibly industry identifier. Where the practice derives revenue from multiple service streams it may also be advisable to segment the revenue streams across services.

(vii) Employees

It is of critical importance that the existing organisational structure is well documented. Employees should be identified by positions and roles, so that a potential buyer can understand the role of various people within the practice and key staff they would want to retain. Job descriptions and individual packages should be detailed along with years of service and appropriate experience. No names or other personnel detail would be provided at this stage.

(viii) Details of operating premises

A detailed description of the premises should be provided.

The information on premises needs to be up-to-date and include:

- general location
- current annual cost of rent
- lease renewal dates
- penalty withdrawal clauses
- physical area of office.

(ix) Detailed asset list

A comprehensive list of all assets to be included in the offer should be prepared. The information memorandum would normally provide details of major items of plant and equipment. Where there is a large number of smaller value plant items it may be preferable to describe these under a broad category heading rather than itemise each asset. Fully itemised schedules will be required when the sale moves to the due diligence phase, and they should be available at the time of completion of the information memorandum. Avoid attaching individual values to asset items. This can lead to debate and negotiation on an asset by asset basis. Normally you would attach a global value to the various asset classes for sale. You should identify where any assets are subject to encumbrances. If it is intended to transfer the asset with the encumbrance then this should be identified in the information memorandum. Alternatively, if the intention is to clear the charge over the asset then this should be noted in your working papers, both for due diligence purposes and also as a matter to be cared for prior to or at settlement.

Information memorandum checklist

Client | Date

1. Obtain financial information for three consecutive years, profit and loss statement and balance sheets	☐
2. Obtain client fee reports – three years	☐
3. Obtain detailed asset register and depreciation schedule	☐
4. Establish goodwill component for practice	☐
5. Provide outline of company background and philosophy to client for their input to content	☐
6. Obtain personnel list and organisation chart	☐
7. Obtain property details for business operation	☐

Timeline and milestone events

The following table provides a guideline to a succession timetable with key milestone events identified. This timetable allows a preferred three year succession timetable. Where you have a lesser period of time you will need to modify the events and time allowed. In general this will have the greatest impact on the time you have available to undertake practice improvement. This timetable has been designed for a sale of practice. For other succession options modify the critical events.

Months prior to succession event	Succession steps	Completed	Comments
36+	1. Review your succession options	☐	
	2. Decide on succession option	☐	
35	3. Undertake a practice diagnostic	☐	
	4. Valuation	☐	
33	5. Establish succession timetable	☐	
	6. Document your succession plan	☐	
32 – 12	7. Undertake practice improvement program	☐	
	8. Balance sheet review	☐	
	9. Taxation review and assess CGT consequences	☐	
12 - 10	10. Develop information reports on client base and revenue by services	☐	
	11. Pre-sale internal due diligence	☐	
	12. Establish sale/transition terms	☐	
9 – 7	13. Valuation test	☐	
	14. Establish marketing approach for the business sale/transition	☐	
	15. Preparation of information memorandum	☐	
6 - 3	16. Agreement on other external advisers	☐	
	17. Put the business into the market	☐	
	18. Enquiry management and filter	☐	
2	19. Contract and due diligence	☐	
1	20. Settlement	☐	
+1	21. Manage post settlement issues	☐	

6. Exit considerations

Compliance issues

When you sell or exit a practice there may be a number of compliance issues that will need to be cared for. Normally these can be divided into statutory, contractual and housekeeping requirements. The following is a list of some of the areas that should be at least considered. Given the variety of succession options and individual circumstances, not every issue will apply in each case. The following checklist provides a simple review process to assist in managing the wind down of your practice affairs.

Issue	Date completed	Comments
Statutory		
1. Do you need to deregister for GST?		
2. If you are deregistering are there any adjustment events that need to be reported?		
3. Issue of PAYG employment statements to former employees.		
4. Deregister for PAYG withholding tax.		
5. Complete SGC superannuation contributions for all staff.		
6. Cancel workers compensation policy and lodge final return.		
7. Cancel payroll tax registration.		
8. If there has been reconstitution of the partnership you may need to apply for a new ABN – normally the ATO will deal with administratively for small percentage changes. In this case you need to contact them to change the ABN details.		
9. Other		
Contractual		
1. Complete all relevant directors resignations and ceasing to act under registered business names.		
2. Where there has been a change in the composition of the partnership, attend to changes necessary for persons owning a registered business name.		
3. Withdraw and remove all relevant guarantees under lease provisions, bank facilities or other areas associated with the business.		
4. Pay out any leases or finance contracts required under assets being transferred to new owners.		
5. Transfer leases or hire agreements on any equipment being transferred.		
6. Deal with staff terminations or payment of benefit entitlements where appropriate.		

Issue	Date completed	Comments
Contractual *(cont.)*		
7. Complete handover and transition support as agreed.		
8. Other		
Housekeeping		
1. Put in place PI run-off cover where appropriate.		
2. Advise PI insurer of the addition or resignation of partners.		
3. Cancel business and property insurances after settlement has been completed.		
4. Obtain a copy of all relevant partnership and shareholder agreements.		
5. Cancel all accounts with creditors or issue advice to them that you are no longer continuing in the business, and where the firm name continues, that they should establish accounts with the new owners.		
6. If you are not continuing in practice, consider whether or not you should cancel your public practice certificate.		
7. Advise your professional body of the change in ownership of the firm, or the introduction or resignation of partners.		
8. Transfer responsibility for all utility connections.		
9. Issue all final accounts to clients for work completed up to the time of sale.		
10. Other		

Staff transition

Where any change takes place in a firm you need to consider the impact on the rest of the team. Depending on the type of succession event the impact will range from minor to major. The better this is managed the smoother the transition will be.

For sales or mergers you need to consider two keys areas – employment entitlements and business continuity.

Employee entitlements

The first area you need to address is whether or not staff are being offered continuing employment with the new practice. Where a position is not being offered you need to consider entitlements to redundancy payments. In some cases where there is uncertainty in relation to their position this can amount to a constructive redundancy, and expose you to redundancy payments. It is important that this is considered in advance of final agreements being completed, as there may be financial considerations that should be allowed for.

Where continuing employment is being offered your staff should receive a letter of offer from the new firm providing them with the full terms and conditions of their employment. A signed acceptance of the offer should be received from the staff and maintained on their employment file. Where continuing employment is not being offered or where the terms and conditions being offered are different from the existing terms of employment, it may be advisable to seek legal advice on your responsibilities under industrial relations.

Staff who will be leaving the firm will have their benefits paid out. With continuing staff you need to agree how their benefit entitlements will be managed. It is not uncommon for benefit entitlements to be transferred from an existing employer to the new employer. These will need to be calculated and agreement on the amounts allowed. Financial adjustments on transfer of employee entitlements would normally be an adjustment item on the contract settlement. Where benefits are being transferred it may be advisable to provide your staff with a statement of their benefit entitlements being transferred.

Business continuity

Where staff are continuing with the firm it is important to keep them well informed on the changes and the forward plans for the firm. Change always brings uncertainty. The higher the level of transparency about what is happening, what changes will occur and how they will be affected, the smoother the transition is likely to be.

The early stages of the succession plan may be confidential, for a number of reasons. This will vary from firm to firm and depending on the succession event. Once the forward position is clear it will be important to let your team know what is happening and then keep them well informed during the transition. Don’t simply assume that they will go with the flow. Respect the fact that this change affects them and they will want to know what is happening. This step needs to be carefully managed and sufficient time allowed.

In some cases your staff will hold strong relationships with the clients. In these cases, the more settled the staff, the more likely it is that this will flow through to the clients. Where there is a sale agreement with earn out or claw-back clauses, this can mean real dollars.

Changes that don’t involve sale or merger of the practice, such as internal succession, retirement of a partner, or introduction of a new partner, still need to consider the impact on your staff. Each of these events involves some change in the fabric and hierarchy of the firm. People relationships are often sensitive areas that are easily overlooked. The more transparent you are in managing this and the more you keep your team informed the smoother the process will be.

Client advice

Clients should be advised of changes within the firm. This would normally be cared for by one or more of the following mediums:

- letter to clients
- client function – normally to farewell or introduce a partner
- newsletter

- website announcement
- personal visitation.

Depending on the nature of the change you may approach different clients in different ways. Large clients of the firm, or those directly affected by the change should have personal contact. Again the nature of the change will influence the approach to be taken. Changes such as the admission of a new partner, will have less impact on clients than changes such as the sale of the practice or the retirement of a long-term partner.

Like your staff clients will want to be informed and know how any changes may affect them. This also provides a great PR opportunity and the chance to update your clients on services being offered and new ways in which the firm can assist them.

7. Additional succession planning support

CPA Australia is committed to supporting practitioners in addressing the issue of succession planning within their practices and to develop plans that best suits individual growth and exit strategies.

We recognise that ongoing assistance and support is required beyond just developing this pathways guide and have developed and will continue to enhance a range of additional resources.

These resources can be accessed online through CPA Australia's practice management knowledge portal at **cpaaustralia.com.au/practicemanagement**

This support includes:

- **succession diagnostic** – obtain a quick assessment within five minutes of your level of succession readiness, along with identification of possible succession options and an indicator of practice value by completing this online test
- **succession planning checklists and working papers** – download many of the checklists and working papers found in this succession planning pathways guide. These are formatted as Word documents so you can work through them on your computer and save for future reference and modification. Go to **cpaaustralia.com.au/successiontoolkit**
- **online tools and resources** – a comprehensive range of online checklists, standard forms standard letters, workpapers, manuals and fact sheets as well as QA and practice management support materials. Covering a wide range of professional areas of interest, these materials are designed to support practitioners to run, manage and expand their practices. Go to **cpaaustralia.com.au/practicemanagement**
- **online member community** – access CPA Australia's Community+ social media platform to connect with other members of the public practice sector. The public practice community fosters like-minded members to work together, share experiences, obtain the latest information about the sector, solve problems and build a referral network. Go to **http://community.cpaaustralia.com.au**

In addition to these resources, succession planning professional development (PD) activities are offered either as part of the public practice convention programs or as stand-alone PD events. Go to **cpaaustralia.com.au/cpdevents**

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