



Valuing a practice

How much is a practice worth? The simple answer is, it depends. **Aidan Clifford** considers some of the factors in the evaluation process



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Buyers and sellers, it goes without saying, have very different priorities in assessing how much an asset is worth. Evaluating the worth of a practice is a question often asked of ACCA's Advisory Services and reflects both the increase in practice merger and acquisition activity and the admission of new partners. Every practice is worth as much as somebody is willing to pay; there is no deep and liquid market to benchmark against and the item being sold, goodwill, is a fleeting and difficult-to-value intangible. There are, though, some guidelines and imperfect valuation methods that are commonly used, but at best they will produce a range of values from which to commence rather than conclude negotiations.

Valuation

The super-profit method is the one method that makes economic sense and is especially suitable to the admission of a new partner. Here is how it works: calculate what the new partner would be earning as a partner. Subtract what their salary as a staff member was and the result is the superprofit. The superprofit is then multiplied by an earnings multiple to get the valuation. The earnings multiple that is used is subjective, but usually ranges from four to six. Four implies an inherent return of 25 per cent and would be used for more mature practice with limited growth potential. Six would correspond to a 16 per cent annual return on investment and be applied to a fast growing practice with a young client base and lots of potential. The concept is similar to P/E ratios where currently rates of five and six are the norm for many high street banks and large manufacturing companies.

The second, more traditional, method is to apply a multiple to gross recurring fees, excluding one-off work. Again, traditionally €1 was paid for every €1 of turnover. For faster

growing practices this could increase to €1.20 or even €1.40 but often for distressed practices could be as low as €0.30. These prices have firmed of late with members reporting €1.20 and €1.30 on some recent deals.

The final method is the client-by-client valuation, where every client is valued on a multiple of between zero and five times the fee. A zero multiple would be applied to unprofitable work or to pro-bono type fees, while five would be applied to fast growing, young clients with very profitable fees.

Although there are three methods to calculate this, an average practice would expect to get the same answer from all three calculations.

Audit files


Other matters that affect the valuation are the quality of the audit files. If there is poor compliance with auditing standards, bringing these files up to standard will incur additional costs on the buyer. Staff with long service entitlements may also affect the price as they will have built up legal employment rights that will be expensive to extinguish, should the need arise. Staff, of course, also add value and there have been purchase contracts where there was a claw back in the event of certain staff leaving within a defined period. Generally a long service staff member being offered a partnership will have the valuation discounted to reflect their long service, a 20 per cent reduction in the market price is not unusual. The sale of a practice after the death of a sole practitioner will generally be at a discount because of the lack of continuity. A period of ill health prior to death will also adversely affect the valuation because many clients may have already moved to another practice if their affairs were not being attended to.

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Payment

There are as many ways of paying for a practice as there are accountants. The traditional approach has been one third on signing, one third at the end of one year and one third at the end of two years with claw backs for lost clients. However, very few follow this traditional model any more with most sellers looking for more up front and less deferred to the future. Some sales are now straight cash deals. Admitting a partner to a practice has even more options. The existing partners will want to put the incoming partner in as much debt as possible, as this will focus their minds wonderfully on growing the business. Incoming partners will want to pay the minimum amount possible, with the ultimate cash-free option being a Dr to the incoming partners capital account and a Cr to the existing partners capital account for the amount of the purchase price. A reduced drawing by the incoming partner will eventually reduce this to zero and the existing partners will be able to draw in excess of their profit share. In practice, a balance between these two extremes is sometimes achieved but the straight cash payment is still very popular. Restructuring the practice into a partnership and limited company is also usually considered at the time a new partner is admitted, but this is the subject for another day.

Buying or selling

So if you are buying or selling, feel free to register your interest with the ACCA Practice Introduction service. Just don't expect Advisory Service to tell you how much the business is worth! 

Aidan Clifford (pictured above) is Advisory Services Manager with ACCA Ireland.