

#### MARKETABLE ASSETS

# The price is right

**Interest from larger firms wishing to expand and from financial planners seeking a new revenue stream is creating a boom in the market for accounting practices.** CHRISTOPHER NIESCHE

**A**ccounting firms are attracting higher prices than they were a few years ago as larger firms buy up smaller practices.

“There’s a lot of consolidation going on, where firms want to be larger and to have critical mass, but they’re not confident enough about their ability to do that organically or they’re just in a hurry,” says Greg Hayes of Hayes Knight. Listed firms, in particular, are buying up practices because they’re under more pressure from their shareholders to grow.

Smaller firms with annual revenue of less than A\$1 million are valued according to their maintainable revenue – that is, after material but non-recurring revenue is stripped out, Hayes says. For instance, a small practice might have earned A\$40,000 in fees from the sale of a client’s business in the past year, but unless the firm habitually advises on business sales that would be stripped out.

“You’re trying to form a view about the revenue figure that’s reasonably likely to continue in the future,” says Hayes.

Practices are typically selling for A75 cents to A100 cents per dollar of annual revenue. While good-quality firms – those that have a stable client base but aren’t too reliant on a single client – are now attracting A100 cents per dollar of revenue. Five or six years ago they were selling for just A85 cents to A90 cents, Hayes says.

The smaller firms typically have up to seven staff and make up the bulk of the market. Indeed, of the 9000-odd practice units in Australia, some 62 per cent are sole practitioners and 83 per cent are either sole practitioners or have just two partners.

Firms with revenues of more than A\$1 million are valued not on their revenue, but on a multiple of their earnings. This is because any acquirer will also have to take on more of the firm’s costs, such as its staff, plant and equipment and its lease.

“Once you start acquiring a firm that is earning A\$2 million or A\$2.5 million, in many cases you’re going to be acquiring part of their cost structure as well,” Hayes says. “That’s why the focus is very much around the profitability, the earnings of the firm.”

Larger firms sell for a little less than smaller firms on a cents-per-revenue basis because “there are certain points in the growth life of a firm where the cost structure gets a bit lumpier”. Quality firms are selling for 3.4 to 4.2 times earnings, Hayes says. As with smaller firms, those prices are higher than five or six years ago, with the multiple up by about 0.5.

Firms with more consulting work, such as providing business advice – which is more

profitable than compliance work – will generally attract higher prices, but only if the income is maintainable and not derived from sporadic or one-off jobs.

Accountancy practices are also sought-after by financial planning firms, both those practices that have financial planning arms and those that don’t.

“We have people coming to us who are financial planners saying they would like to purchase up to six accounting practices,” says Paul Tynan, chief executive of Kenyon Partners, which acts as a broker for financial planners.

The planners are seeking the income stream from the wealth-management arms of accountancy practices. A financial-planning arm can significantly boost an accountancy practice’s sale price because they are valued at about 2.5 times annual income, much higher than the non-planning part of the practice, Tynan says.

But financial planners are also seeking accountancy firms without a financial-planning arm to access new product distribution opportunities to the firm’s clients.

“People out there are looking to purchase accounting firms because accounting firms have a very good trust level with their clients,” Tynan says. “They’ve basically dealt with their clients on the compliance and the tax side, but they haven’t really done very much on the financial planning side.”

With baby boomers starting to retire – the average age of an accounting firm principal is about 57 – more firms will be coming onto the market. But Hayes says there’s no sign yet of a glut of practices up for sale.

“We’re seeing the early stage of succession occurring,” he says. “You’d expect that if there was a flood of practices that came onto the market at the one time it would push prices down, but we haven’t seen that yet.”

Hayes says most good-quality practices are selling within three to four months of being put on the market. But he warns against putting a deadline on a sale and being forced to take a lower price.

“If someone tries to pick their exact time to exit, that’s really dangerous because there’s no guarantee that there’s a buyer there,” he says. “You’ve really got to have a sense that ‘over the next couple of years if the right buyer comes along I’m prepared to acts.’” ■



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## SETTLING OUT OF COURT

# The gloves are on

**The Australian Tax Office is keen to settle more SME tax cases out of court – particularly those relying on interpretation of tax laws, but concedes this will require a major mindset shift.** CHRISTOPHER NIESCHE

**T**he Australia Tax Office (ATO) is increasing its efforts to use alternative dispute resolution (ADR) to settle tax cases with small to medium business (SMEs).

While it has always been able to settle disputes with SMEs, the ATO has been more actively pursuing settlements in recent years, and plans to release a booklet encouraging ADR – negotiating a settlement of a dispute before it gets to court.

Michael Cranston, ATO deputy commissioner for SMEs, describes ADR as “a fair outcome and a significant cost reduction for taxpayers and us”.

“There’s probably been a bit more of a push for us to settle matters to stop filling up the courts,” Cranston says. The ATO has also expanded its programs aimed at high net worth individuals and SMEs over the past four years.

“There’ve been more audits out of that, so we’re encouraging more settlements,” Cranston says.

Providing further impetus, litigants are required to show they have attempted to settle their disputes before resorting to litigation. For the past five years the Australian Government has been pushing its agencies to settle more disputes through ADR. In 2011-12, the ATO settled 49 disputes with SMEs, and 41 the year before.

The type of issues settled ahead of court action are generally those that rely on some interpretation of tax laws and don’t simply turn on the facts.

The ATO often settles capital gains tax (CGT) assessments and the use of trusts and company structures, particularly when a business owner is selling up. “Sometimes we’ll look at the CGT provisions, as they can be slightly arguable,” Cranston says. These cases often also involve Part IVA anti-avoidance provisions of the Income Tax Assessment Act.

Valuation matters, linked to CGT issues or

in relation to equipment write-offs, are “very arguable” and important to settle, Cranston says. As they often rely on contrasting expert opinions, disputes are hard cases to argue in front of a judge, and are of little value in setting tax law precedents. Residency disputes can also be solved by ADR, but the ATO generally refuses to settle aggressive tax-evasion and fraud cases.

Even where a settlement is not reached, the process can be of value in narrowing the range of matters that have to be argued before the court.

While the ATO’s policy is to settle where possible, it can make an exception for instances where tax law is unclear or yet to be tested.

“We don’t encourage trying to take cases where it might be something just confined to the facts,” says Debbie Hastings, first assistant commissioner, Law and Practice at the ATO. “We’re really looking to litigate around questions of law where we can get that certainty for the wider community.”

Settlement can be reached at any point after the ATO issues a position paper. Some businesses prefer to settle early because an adverse assessment could create a liability and affect their obligation to their bank, says Sue Williamson, a partner in the tax and law section at Ernst & Young.

Williamson says businesses still need to seek advice on the best way to challenge an assessment. “It does open up more alternatives, but ... if you don’t have access to the proper advice and the best way to go about challenging something ... you might not get it as well done as it should be.”

Williamson, who is a member of the ATO’s Dispute Resolution Sub-Committee, says she is pleased with the start the ATO has made in introducing ADR, but there is more to be done.

“The main problem is the fact that the very senior people in the ATO have embraced ADR ... they just have to get the message down lower,” she says. “You can sometimes get people in there who either don’t agree with the concept of ADR or who haven’t had the right training to approach it in a way that they’d get a positive outcome.”

Hastings acknowledges these concerns, but says they also apply to the private sector. “Everyone involved in the process has a lot of learning to do here,” she says. “We’ve all learned the adversarial approach to litigation, and what we’ve got to do is change the mindset and I think this is everyone who’s involved.” ■