

# Top Line or Bottom Line

Accountants keep asking me, 'How much is my practice really worth'?

My standard answer for firms with gross fees under \$1M is show me the last 3 years financials and a breakdown of the fees between business and individual returns and I will give you a ball park figure. Practice sales this year support the fact that the 'cents in the dollar' valuation method still applies for practices with fees less than \$1M. As you will see below, this is not sustainable and increasingly the focus will shift from the top line (gross fees) to the bottom line (net profit).

Income	Practice A	Practice B
Gross Accounting Fees	\$354,500	\$359,200
Number of Staff (Excl. Principal)	2.0	2.8
Earnings Per Full Time Employee	\$118,116	\$94,526
<b>Expenditure</b>		
Wages & Super	\$94,000	\$176,000
Rent & Outgoings	16,000	22,000
Computer Expenses	7,400	7,200
Operating Expenses	<u>49,900</u>	<u>65,100</u>
	<u>167,300</u>	<u>270,300</u>
<b>Net Profit</b>	<b>\$187,200</b>	<b>\$88,900</b>



To illustrate this point let's look at two similar size practices we have sold. Despite the two firms being similar in fee size, their staffing levels, profitability and 'real' values are poles apart.

The top line valuation approach simply makes no sense in this comparative example. From an investor's perspective, there is no way they are worth the same amount which is the result if you applied the cents in the dollar method. In actual fact they sold for almost the same price which is a reflection of the current seller's market we have in Victoria.

The alternative valuation method is based on earnings before interest and tax (EBIT) after allowing for a notional salary for the principal. In this instance let's examine the value of the two practices:

	Practice A	Practice B
Earnings Before Interest & Tax	\$187,200	\$88,900
Deduct Notional Salary for Principal	\$120,000	\$120,000
Adjusted Profit	\$67,200	-\$31,100
Profit Multiple	3	3
Value	\$201,600	\$0
Cents In The \$ Conversion	\$0.57	\$0

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The moral of the story is you need to address your profitability well before you put your practice on the market. There are a number of simple ways to make an immediate impact on your profit including:

- 1 Add a range of additional service offerings to your clients. In previous editions of The General Journal we have reviewed the income potential of opportunities such as leasing, lending, audit insurance and risk insurances. In addition, Workcover incentives and tax effective investments have also been examined. Most sole practitioners also have a referral relationship with a financial planner and managed correctly this opportunity can prove very rewarding.
- 2 Another common mistake is taking on clients who are simply 'break-even' jobs. They lift your top line but do nothing for your bottom line because they are just write offs waiting to happen. Poor records, bad payers, they only want compliance and they simply don't appreciate the value of your services. They make you busy but not profitable.
- 3 Be selective, set criteria and standards for clients. Remember, GST has made you a very valuable commodity and the ageing demographic will make you even more valuable in the future.

Eight years into GST, most smaller firms are doing things exactly the same way as they did back in 2000. If you accept shoebox records, computerised shoeboxes and code source documents then you'll get what you deserve – write offs, dissatisfied staff, poor profits and problems when you look to sell your practice. You simply can't charge accounting rates for what is essentially low end bookkeeping work.

It fascinates me when firms complain they can't get (good) staff and have workflow, debtor and job turnaround problems. Ask yourself the question - What do your clients know about accounting? Generally, very little. Why then have most firms got their clients using double entry accounting programs and expecting quality, reconciled records?

Give your clients a simple single entry bookkeeping program like Cashflow Manager and you'll get a different result and bottom line. But how do you get clients to convert to Cashflow Manager after 8 years of 'learning' accounting? Simple. You are their 'financial doctor' and you simply issue the prescription for Cashflow Manager.



Thinking of selling your practice? We are dedicated to 'Helping Accountants Succeed' and call us today on (03) 9824 5300 for an obligation free discussion.

*Pat Camm*



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