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# In front of the DEAL

Accountants share best practices for preparing to buy or sell a business

By KRISTEN D'ANDREA

While organization is always important, making sure their house is 100 percent in order is critical for companies looking to purchase or sell another business.

It's a fairly simple idea, according to Michael Lopez, a partner in the closely held business services practice at EisnerAmper, which has offices in Melville and Syosset.

"The more an acquirer sees things are done right," Lopez said, "the less they're going to dig."

Still, owners of closely held businesses — particularly family-owned firms — often take the back office for granted, leaving critical accounting aspects unaddressed. When the opportunity to buy or sell arrives, these companies must scramble to get their financials in order, or risk losing the deal.

"You cannot imagine how many companies let the back office fall through the cracks," Lopez said.

But it's understandable, he added, noting business owners are "busy building a business and focused on driving the top line." EisnerAmper,

he said, is often hired to clean up those types of situations.

The majority of clients at Albrecht, Viggiano, Zureck & Co. in Hauppauge are closely held businesses whose owners' retirement plans often involve selling the business. First, "I advise them to clean up their balance sheets," noted partner Michael Collins.

Nobody wants to take on a business with miscellaneous assets and liabilities, such as employee or office loans, Collins said.

"I tell clients to take their five cars or their brother-in-law's health insurance off the books," said Collins, who also advises clients to stop using tax planning as their bottom-line planning.

"You should show your profits and pay your taxes," he said. "People want to buy a profitable company."

One of the first steps for a company considering buying or selling is to get to know all of the parties involved, according to Cliff Maldow, a partner at Jericho accounting firm DDK & Co. Maldow advises clients to check backgrounds of potential owners and buyers to ensure they're reputable and have related industry experience. The ideal purchasers are companies already in the same industry with infrastructure and

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## Due diligence strategies for buyers, sellers of businesses

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overhead in place, he said.

Once it's determined that all involved parties are solid, it's time to look at basic financial statements and tax returns, which will have a large bearing on a purchaser's reliability, Maldow noted.

Lopez recommends acquirers view a company's audited financial statements.

"An audited financial report will give a purchaser the best comfort in the reliability of the reports," Maldow agreed, noting he suggests looking back six years to identify trends such as sales growth, strong margins and changing overhead.

"If the sales, expenses and margins stayed the same, that tells you the company is stalled," Maldow said, and that could signal a buying opportunity for a purchaser who knows how to turn around stagnant growth.

Once a purchaser determines a company's financials are strong, it's time to dig even deeper. Accounting firms are often called on to do due diligence, reviewing underlying books and records, contracts, assets, operations, suppliers and vendors, after letters of intent and non-disclosure agreements are exchanged by both parties.

"You have to look at nonrecurring income or expenses and take them off the table," such as an owner who may work 80 hours a week but not take a salary, Maldow said.

"That may increase the profitability of the company but, the fact is, you'll have to replace it and draw a salary," he added. "You have to normalize profits to see what the actual picture is."

When purchasing a business, buyers can choose to make either a stock sale or an asset sale, noted Scott Sanders,



**CLIFF MALDOW:** Look at six years' worth of financial statements when evaluating a business for purchase.

Photo by Bob Gigliore

managing partner of Sanders Thaler Viola & Katz in Jericho. In an asset sale, buyers can cherry-pick the assets they want to purchase, such as a company's inventory or name; in a stock sale, Sanders cautions, the purchaser is buying the entire company, along with its liabilities.

"A lot more due diligence is involved [in a stock sale] to find any hidden liabilities owed," he said.

"My advice is generally don't buy the company, buy the assets," Maldow said, noting purchasers of a company can be liable for all debts and obligations, including those that aren't currently on the books, such as lawsuits or unclaimed

pension obligations that could arise down the road.

Rather, Maldow recommends buyers purchase a company's assets and put them into their own entity, such as a limited liability corporation.

Purchasers are then ready to make projections as to what the profitability of the company will be in the next five years. Then, an acceptable rate of return on the purchaser's investment can be determined, Maldow said.

"Generally, valuation of a company is determined by a capitalization of earnings," he said.

When determining a pricing structure, it's important to consider certain assets that are subject to bulk sales tax, Sanders said. For instance, a company selling its inventory is responsible for the bulk sales tax on it, noting \$1 million worth of inventory could be subject to the sales tax rate in the state where the transaction took place; otherwise, the purchaser could become liable for tens of thousands of dollars.

Not being in compliance with sales tax rules can be a "huge hidden liability," Lopez agreed, noting it can detract from a company's value.

It's important for attorneys to get involved in the allocation of a selling price, Sanders said, noting both parties generally want better tax treatment. Sellers usually look for a stock sale, which offers long-term capital gain, while buyers tend to want to only purchase assets, in order to get favorable tax treatment, Collins said.

The bottom line, whether buying or selling, is for business owners to do their research.

"Know what you're buying and how [companies] are bought and sold," Collins said. "A lot of businesses have formulas. You should know the formula and use it as your measurement."