

An Alternative Exit Strategy

In July 2016, I published a column titled "**The Barbarians¹ have passed the Gate**".

In this column, I made the hypothesis that "Big Law" did not believe they needed a dog in this fight as the law firms operated by the big accounting firms appeared not to be initially focused on high-value work. Based upon this hypothesis, I conjectured that it was the mid to small law firms that should be more concerned as the impact was twofold:

1. Unlike most law firms, the Barbarians see investing in their future as a "no brainer decision" (and not subject to a consensus decision making process).
2. The work they appeared to be going after was the "sweet spot" for mid to small size firms.

Both the progress by the Barbarians and the reaction by mid to small size firms have been underwhelming (a.k.a. complacent).

Roll ahead four and a half years and all four major accounting firms have their law practices up and running, with varying degrees of success.



One of the major hurdles continues to be the cultural gap between accountants and lawyers and how they conduct and manage their practices is real and palpable (remember Donahue & Partners). This over-dependency on an accountant's approach can cause a stressful "we versus they" environment (e.g., length of time to become a partner; titles in an accounting firm are much more important than a law firm and thus respect for them is quite different).

Until this issue is addressed to everyone's satisfaction, there could be a "revolving door" effect at these law firms.

Despite this challenge, I have a growing sense that accounting law firms might become a leading alternative exit strategy for sole proprietors and small firms.

First, the statistics from the 2018 Federation of Law Societies states:

- Less than 1% of the firms in Canada – are over 50 lawyers.
- Over 34% of the members have been practising for more than 25 years. This group appears to be growing faster than the number of new lawyers being admitted (as



Stephen Mabey, CPA, CA
Principal & Managing Director

well, 10% have been practising between 21 to 25 years).

- Over 72% of the firms are sole proprietorships.
- Over 24% of the firms are 2 to 10 lawyer firms.
- With most firms being sole proprietorships or less than 10 lawyer firms, often the “exit strategies” have been limited to:
 - Wind up their practice, following the local bar society regulations, or
 - Find a younger lawyer willing to buy their practice – often on an “earn-out basis” – which is a percentage of future revenue for a fixed period (a hybrid of a referral fee).

Rarely do either of these approaches result in partners being compensated for the “goodwill” they have spent their practice life building up. (This “goodwill” relates to the law practice, not to the individual person and is commercially transferable.)

The accounting law firms offer to a specific group of practitioners and their firms an alternative “exit strategy” that does result in their being paid for the goodwill their efforts have created. These firms have restricted its focus to areas of law that are supportive of its multi-disciplinary approach towards client service.

These core areas of practice include:²

Deloitte Legal Canada LLP:

- Tax litigation and controversy
- Tax advice
- Corporate and commercial law
- Employment and labour law
- Data privacy and cybersecurity

These firms have restricted its focus to areas of law...

PwC Law LLP:

- Tax law
- Immigration law
- Tax dispute and resolution

KPMG Law LLP:

- Business law
- Employment and Labour Law
- Estates and Trusts
- Immigration Law
- Tax Law and Tax Litigation

EY Law LLP:

- Corporate and commercial
- Corporate secretarial services
- Business immigration
- Tax planning
- Tax controversy

It is deliberate on the part that of these firms that they are not seeking to grow a Personal, Civil, and Commercial Litigation practice (other than management side tax and employment litigation). In part, because of the very nature of their relationship, the magnitude of likely conflicts would render these types of practices financially unviable.

Like any opportunity, this exit strategy³ has both pluses and minuses, and firms must weigh the full offer to see if it works for them. (The following are the general pluses and minuses which will vary depending on what your practice/firm has to offer and what each accounting law firm is looking for.)

Like any opportunity, this exit strategy has both pluses and minuses...

The perceived pluses include (in no order):

- Dealing with an entity that has the financial wherewithal and stability to not only fund the transaction but future investments in professionals, the technology required by practitioners wishing to practice law at the highest level and the internal resources to provide the personnel support to sustain the desired level of client service.
- Receiving payment upon execution of deal - varies from firm to firm but generally, there is an upfront payment and a future payment.
- Two-part purchase price:
 - A multiplier⁴ is applied to the deemed "transferable revenue",⁵ plus
 - Dollar for dollar of Work-in-Progress ("WIP") at the time of the execution of the deal.
- All other assets (including accounts receivable) and liabilities are left for the acquired practice to wind up as the accounting law firms are generally acquiring the practice and not the firm (e.g., so no issue if the partner(s) have other assets in the practice).
- They will interview all employees. Those brought over to the accounting law firm, any future severance liability transfers to them. Severance liability for employees not hired by the accounting law firm remains with the acquired firm.
- Partners in the acquired practices will normally be offered either income or equity partner positions.⁶
- The criteria their compensation system incorporates are different (not better or worse) than your typical law firm having reached the next plateau of incorporating team play and cross-selling.
- Most offer flow-through capital accounts via their equity loan program with national banks that the accounting firm does not audit. The partner borrows from the bank; pays the interest on it (standard is prime plus 1/2 to 1 per cent), and when they retire, the money is paid back to the bank (unless, of course, the lawyer has already paid the loan off). There is an offset as the accounting law firms generally pay the partner prime plus 1/2 to 1 per cent on their capital account balances, so it nets out (unless the lawyer can negotiate a better rate at the bank and then the lawyer can be in the money).

- Lawyers looking to practice law without being drawn into firm management but want consistent execution of management policies will see a benefit. Accounting law firms are generally analytical organizations (no surprise) where decisions like – staffing, pricing, continued investment in areas of practice, etc. – are largely driven by data generated by their systems and less on instincts (heavier on the analysis).
- From my discussions and readings, it is apparent that considerable thought has been spent on developing a strategic plan for these accounting law firms. Unlike many firms, this is not a “static” strategy (if it, in fact, even exists) that sits on a shelf to be dusted off every 3 to 5 years. These firms have embraced what appears to be a dynamic strategy where the plan is a continuum rather than an absolute.

The perceived minuses include (also in no order):

- “Transferable Revenue”:
 - Because these firms do not embrace a litigation practice (other than management side tax and employment litigation) lawyers will not receive 100% of the revenue you have built up.
 - Practitioners will not continue to practice with long-standing colleagues if their chosen practice area is not one that the accounting law firms are pursuing.
 - The practice's current and future client base could be reduced because of “auditor independence” rules. Although in fairness given the targeted practitioners/firms' size, any SEC and other public companies' conflicts are likely minimal.
 - The accounting law firms tend to adjust any future purchase payment for any shortfall that occurs in reaching the agreed-upon transferable revenue number.
- The mandatory retirement age could result in the firm's largest business generators not being admitted to partnership and potentially taking their “book of business” elsewhere which directly impacts the lawyers currently benefiting from the senior's practice.
- The practice of law in many law firms is not a team sport and so the introduction of performance bonuses, both firm and individual, is somewhat of a foreign concept.
- While the average realization rate may equalize the hourly rates between accountants and lawyers, the standard (rack) rates are substantially different (accountants' rates are normally significantly higher). Therefore, quoting higher standard rates (even while offering discounts) may drive current and potential clients to competing law firms.

Like all exit strategies, the foregoing “alternative exit strategy” will not work for every practitioner or firm. But it has sufficient merit that it is clearly worth exploring.

It is also my impression that everything I described is open to negotiation as part of any eventual deal.

***What is in it for the
accounting law firms...***

I would be remiss to not address what is in it for the accounting law firms. Their goals appear to be:

- Better service for their existing client base,
- Increase the share of client professional fee spend by offering them one-stop shopping,
- The accounting firms provide many referrals to other law firms. By building up their own law firms, they can keep this work in-house, and
- Leverage existing external relationships.

Deloitte Legal Canada LLP (4), PwC Law LLP (6) and EY Law LLP (7) indicate a presence in the major metropolitan cities in Canada whereas KPMG Law indicates they have offices in 41 locations (which includes those cities).

If you think your individual practice or firm loosely fits within the above parameters and wish to obtain a fuller understanding of the possibility of joining one of the accounting law firms as an exit strategy, I suggest you contact them directly (websites have contact information) or if I can be of assistance please do not hesitate to contact me.

No matter which exit strategy you and/or your firm chooses, remember the age-old axiom:

“In business, you don't get what you deserve, you get what you negotiate.”

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1. The word "Barbarian" originated with the Greeks, and later, the Romans used the same term to describe anyone who was not Roman.
 2. Taken from their respective websites.
 3. Deloitte Legal has basically been cherry picking individuals and growth has been slow but strategic as a result their financial offerings may not be the same as the other accounting legal firms (e.g., buying WIP).
 4. The multiplier will depend on several factors but normally is reflective of the marketplace and position of the practice in that marketplace.
 5. This means only fees for clients that meet the core practice areas and are not conflicted out by "auditor independence" regulations for SEC and public companies, as well as some private companies that might already engage the accounting law firm's services.
 6. The accounting law firms like the accounting firms do have a mandatory retirement age of. However, they will likely consider "Of Counsel" type positions for a 2 to 3-year term for partners over the retirement age at the time the practice is acquired.
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Stephen Mabey is a CPA, CA and the Managing Director of Applied Strategies, Inc. Stephen's focus is on law firms in general and on small to medium size law firms in particular. He has written about and advised on, a wide range of issues including - leadership, business development, marketing, key performance indicators, strategic planning, mergers, practice acquisitions, competitive intelligence, finance, mergers, practice transitioning, compensation, organizational structures, succession and transition planning, partnership arrangements and firm retreats. In 2013, Stephen was inducted as a Fellow of the College of Law Practice Management in recognition of his sustained commitment to the highest standards of professionalism in law practice management. For more information, visit appliedstrategies.ca or connect with [Stephen Mabey on LinkedIn](#).

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