FEATURE

Accounting for the Transition: Part 10 of a Series on Buying and Selling a Practice

Steps that need to be taken by both parties to ensure a successful transition

By Ernest Wolkin, CA

In a transaction of purchase and sale, the transition period really begins after the offer is accepted and ends after the vendor has received the remainder of their outstanding accounts receivable. In this article, we will identify steps which should be taken by both the vendor and the purchaser to comply with government requirements as well as discuss financial issues to help ensure a successful transition.

THE VENDOR'S PERSPECTIVE

Although most financial matters surrounding a purchase and sale transaction involve the purchaser, there are a number of issues which pertain to the vendor. Some of them evolve directly from provisions in the agreement. They include:

Employees

The vendor must ensure that wages are paid up to the date of closing. Furthermore, he or she must calculate and pay outstanding vacation pay and severance, if applicable. In most cases, a record of employment must be provided for each employee, indicating a change in ownership as the explanation. This assumes that the employee is continuing with the new owner. These must be issued within seven days of closing.

Suppliers

Not only must suppliers be informed of change in

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Note: There are several legal and financial issues that need to be considered if a chiropractor is buying or selling his or her practice. This series of articles by Allan Freedman, BA, LLB and Ernest Wolkin, CA, has addressed various issues throughout the process of transferring a practice from one chiropractor to another since February 2000 (Vol. 5 Num.1). The last article, featured in October 2001, titled 'Completion of the Transaction,' focused on providing all necessary documentation to finalize the agreement. For those who wish to read previous installments of this series, back issues can be purchased from Canadian Chiropractor.

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ownership but outstanding balances must be paid. This is especially critical where the name of the clinic is retained. Unpaid bills could inhibit the operations of the purchaser by affecting not only the amount of future credit to be granted to the purchaser but also affecting the reputation of the purchaser.

Tax Filings

Returning to the employees, it will be necessary, in most cases, to issue T4's. The timing depends upon whether the vendor will be continuing in business elsewhere subsequent to the sale. If the vendor ceases business, they are required to issue and file with Canada Customs and Revenue Agency (CCRA) the necessary forms within 60 days of ceasing business. If they continue in business under the same name elsewhere, the requirement is to issue T4's and file them with CCRA by February 28 for the previous year. It is also imperative that payroll deductions are paid to CCRA in full, especially where the name of the clinic is also transferred to the purchaser. Once again, an unpaid balance could result in CCRA action against the purchaser, by mistake. The filing of other required returns would include GST or HST if the clinic were a registrant. The filing of PST may also be required. If there is PST included in the purchase price (i.e. for equipment, furniture, etc.), this is usually remitted by the vendor's lawyer. Any outstanding balances should, again, be paid. The respective ministries should then be informed that the accounts are closed because the business has been sold.

Other issues not necessarily covered in the agreement, but equally important to the vendor, include:

Accounts Receivable

It was mentioned in an earlier article that the accounts receivable are typically the property of the vendor. However, the mechanics of collection are not usually specified. The first step during the transition is to establish the exact amount of accounts receivable owing from patients and private insurers. The balances owing must be mutually agreed upon between vendor and purchaser to ensure that the appropriate receipts are remitted to the vendor when they are received. Staff particularly must be informed and a procedure implemented. Vendors should absolutely not harass patients for outstanding amounts as this could severely impair the goodwill of the practice.

Income Taxes

Aside from any outstanding loans, income tax is usually the largest financial cost incurred by the vendor. The planning for income taxes should take place even before the practice is offered for sale, because the tax implications can significantly impact what the vendor is willing to accept as a sale price. The vendor should be reviewing with their accountant the potential taxes and planning to set aside funds from the sale to cover the balance. This is critical to avoid painful surprises at tax time.

THE PURCHASER'S PERSPECTIVE

During the transition period, the purchaser is preparing to go into business. As such, many of the issues affecting a general business start-up apply here. In addition, the purchaser must be aware of additional responsibilities that evolve from the purchase and sale agreement.

Transfers From Vendor to Purchaser

• Name registration — If the practice has a generic name and the purchaser has chosen to utilize it, the name registration must be transferred and registered.

• Telephone, facsimile — Utilities, including the phone company need to be informed of change in ownership so that all utilities accounts are transferred to the purchaser.

• Leases — Assignment of leases for space and equipment need to be obtained in order to ensure that purchaser has the continued right of usage. In an earlier article we addressed the need to have an assignment or renegotiate the lease of the premises, but it is equally important to obtain assignments on any equipment or furniture under lease. Once done, it is necessary for any pre-authorized payments to be transferred to the purchaser's bank account.

• Licences — Any licences for intangibles such as copyrighted or trademarked names must be either assigned or repurchased. In the case of computer software, licences for use typically have to be paid for by the new owner.

• Patient files — Most important to be transferred to the purchaser are obviously the patient files. In this regard, all active and inactive files need to be provided. Certainly, the financial information pertaining to those files needs also to be provided.

• Accounts Receivable —Where the accounts receivable are the property of the vendor (most situations), the information transferred is the balances owing. The purchaser is responsible for collection and then remitting the outstanding balances to the vendor. It is critical that procedures are implemented at the outset and the appropriate staff informed. The outstanding balances of the vendor should be collected with the same diligence that the purchaser implements for their own receivables.

Establish Accounts

The purchaser needs to set up certain accounts. These fall into the categories of financial and government compliance.

On the business side, new accounts need to be established for the following:

- bank account;
- supplier accounts;
- provincial health plan account;
- WSIB account.

In addition, the purchaser should obtain insurance coverage dealing with malpractice and office issues. Other insurance coverage necessary would include: office overhead, disability and life insurance. Ensure that premiums, except for life and disability insurance, are paid through the practice bank account. Where a financial institution has required life insurance to support your loan, that premium should also be paid from the practice bank account.

From the standpoint of government compliance, it may be necessary to establish accounts other than that of your personal income tax. It would firstly be wise to obtain a Business Number (BN number) from CCRA. This number is the basis for GST, Payroll and Corporate Income Tax accounts. Once the number is obtained, it is necessary to determine if you require accounts for payroll and/or GST. The need for a payroll account is determined by the existence of employees. If staff are employed, a WSIB account may need to be established and those staff may be covered with WSIB.

Decisions pertaining to GST registration will be dependent upon whether the practice is providing "taxable supplies." These would include such things as massage therapy, acupuncture and the sale of various items. Even then, one is only required to register when $30,000 in revenue from taxable supplies is reached in a fiscal year. The purchaser should consult with their accounting advisor to determine whether registration for GST is required or would be beneficial.

Business Plan

Many purchasers are under the illusion that taking over a "turn-key" practice requires little, if any, financial planning. Some purchasers only prepare a forecast or budget because the bank requires it. To ensure financial success, during the transition and beyond, a purchaser should plan their future. Critical to that process is the preparation of information to plan and then monitor the financial progress of the business.

A monthly forecast or budget should be prepared that encompasses revenues and expenditures. The budget would incorporate the expectations and objectives of the purchaser. It should also be used to determine the necessary financing for the purchase and for ongoing operations. Needless to say, this should be prepared very early in the purchasing process.

To monitor the purchaser's progress, monthly financial statements should be prepared. These can be compared to the forecast. One must first have a "set of books." A bookkeeping system should be set up and implemented upon closing. Many good bookkeeping/accounting software packages are available, most of which will provide comparisons to budget reports.

Purchasers should consult their accounting advisors to obtain assistance in preparing a forecast, setting up the bookkeeping system, preparing monthly financial statements and advising on the financial aspects of the purchase itself. •

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