FEATURE

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ACQUIRING ASSETS
through the Purchase of a Practice

What should be included in the transfer of a practice, and just as importantly, what constraints do the parties have in dealing with assets of the practice?

AF: Having dealt with the value of the practice, it is important to keep in mind that the purchase price will be based not only on the value of the practice but on additional factors as well. These factors include the timing of the practice (i.e. whether the vendor requires an expeditious completion of the transaction); how the practice is to be financed; and what is included in the purchase price. As in the discussions that have taken place concerning associateships, many of the issues involved in a sale/purchase of a chiropractic practice are interwoven as part of a big picture. It would be foolhardy and quite impractical to deal with any particular issues such as billings or a purchase price without looking at other issues such as staff turnover, what assets are included, or the patient base. As such, the topics dealt with previously may well be raised again in a different context or as indicated, in the "big picture."

What should be included in the transfer of a practice, and just as importantly, what constraints do the parties have in dealing with assets of the practice?

It would appear trite to indicate that a vendor can only sell what a vendor owns. However, that is not necessarily the rule that governs a commercial transaction. The better principle to work by is that a "vendor has the right to transfer any interest which he, she, or it may have in an asset subject to any constraints which may be placed on that transfer." For example, if a doctor has purchased a computer, he or she may sell it to a purchaser, if there is no lien placed upon the equipment; if the equipment is actually owned and not leased; and if the doctor, rather than a management company, is the owner. In any event, even if the computer can be sold—it is surely also trite to indicate that the computer software cannot be sold—it can only be assigned pursuant to the software agreement that generally exists and governs the acquisition of the software by a person purchasing the software from a retail vendor.

EQUIPMENT NOT OWNED BY THE VENDOR

If equipment is the subject matter of a lien by a lender such as a financial institution, it is imperative that the vendors ensure that the lien can be lifted prior to the completion of the transaction or by using the proceeds obtained at the closing of the transaction. Vendors obligate themselves to discharge such liens pursuant to the agreement of purchase and sale. This principle likewise applies to equipment that is leased. If the purchaser is to assume the lease, then prior to signing any sale agreement, the vendor should ensure that the lease agreement could be transferred to the purchaser and at what cost. The leasing company may require that the vendor purchase the equipment or "pay off" the lease prior to any transfer of the equipment.

If a management company owns the equipment, then it is imperative for the vendors to ensure that the management company is a party to the sale agreement. At closing, a vendor would not want to be surprised with an uncontrollable situation of a management company being unwilling to transfer the assets.

TAKING INVENTORY

The purchaser should review the practice location of the vendor very carefully to ascertain what is to be included at the time of the closing of the transaction. The list of assets being transferred would include a comprehensive list of each asset and might include the following: receptionist desk, chair, reception shares, end table, pictures, filing cabinets, telephone system, radio, television, refrigerator, fax machine, photocopier, computer, assignment of computer software, exterior sign box and sign, treatment tables, view box, x-ray, developer, office desk, chairs, skeleton, fire extinguisher, smoke detector, and plants. This list is by no means comprehensive. A purchaser would be well served by visiting the location at least twice to confirm the creation of a comprehensive list of assets for inclusion in the purchase agreement.

With respect to assets such as an x-ray machine, photocopier, computer, etc., a purchaser should have a provision inserted in the offer whereby the vendor agrees that the assets will be in good working order on closing.

While the assets should be in the same condition as when the offer was presented (with or without a clause requiring them to be in good working order) it is not uncommon for a purchaser to fail to examine and try out all equipment prior to the offer being signed. This is a clear example of when the principle, "let the buyer beware," applies.

In addition to the above mentioned assets, a purchaser should have specific regard to the following assets:

1. Patient Files: The files should be transferred to the purchaser in their entirety. This should include all old files (which may be used to reactivate a relationship between the doctor and a patient) in the possession of the vendor, together with all x-rays relating to the files. The vendor should require that the purchaser maintain the records for at least seven years after the completion of the transaction and in addition, the vendor should ensure that he or she has reasonable access to the files, or a copy of them, if required by law (this might include matters such as a malpractice claim, billing dispute, a licensing board issue, or an income tax audit).
2. Financial Records: Insofar as the purchaser might require financial records for the ongoing care of patients or the maintenance of the practice, the purchaser should obtain such financial records. Again, the vendor should ensure that he or she has access to the records as may be reasonably required and that such records are not destroyed except in accordance with the sale agreement.
3. Supplies: Any supplies that are customarily maintained at the practice should be included in the purchase price. The vendor should agree to maintain the level of supplies in its usual quantity.
4. Inventory: If the vendor maintains products such as orthotics, vitamins, or back supports, the purchaser will want to ensure that they are being acquired at the cost that the vendor paid. The purchaser should also ensure that the inventory is in merchantable condition (that is, that each of the products is saleable). For instance, the packaging should be in a proper condition and/or the product should not have reached or approached its expiry date. Lastly, the purchaser will want to ensure that the level of the inventory of the vendor is maintained in its usual capacity.
5. The computer software will require, as indicated, an assignment of the software license agreements. If such software is created by a particular software producer, the license agreements should be reviewed carefully to determine whether there are any restrictions affecting the transfer of the software in addition to the cost associated with the transfer.

The vendor should ensure that any assets that are to be transferred to the purchaser are subject to a bill of sale being provided to the purchaser. If assets are leased, then the terms and conditions of the leasing arrangements should be reviewed carefully and dealt with in accordance with the lease and the purchase agreements. It is most important that the vendor review any appropriate documentation relating to the ownership and leasing of equipment prior to executing an agreement relating to the sale of a practice. Being surprised after signing an agreement can be an expensive enterprise.

To maximize sale value, the vendor should be searching for purchasers who practice in a similar style and who utilize the same types of equipment.

From the position of the purchaser, the assets specified in the agreement of purchase and sale must be in existence at the time of closing, in good working order, and free and clear of all encumbrances. A purchaser who has paid a significant amount of money for a practice will be loath to have to expend any further funds to equip the office, whether that involves the replacement or addition of assets. The fact that a vendor has an extensive amount of assets is of little concern to a purchaser who is generally concerned only with the purchase price and the ability to maintain the practice in its previous state after the completion of the transaction.

EW: The assets other than goodwill can be a significant component in the overall value of a practice. With the pace of changing technology and the move to multi-disciplinary and rehabilitation clinics, both the overall cost related to these assets and the degree of obsolescence are becoming more important to their value.

Before assessing a value for a particular asset, a purchaser should first determine if they would utilize that asset in their practice. An asset they won't use has no value as far as the practice is concerned. This issue is extremely important from the vendor's perspective also. To maximize sale value, the vendor should be searching for purchasers who practice in a similar style and who utilize the same types of equipment.

VALUE IN USE

What is the most appropriate measure for value of a particular asset? To determine fair market value, many approaches can be taken. For a practice that has wound down and has no value beyond the equipment, net realizable value might be used. In some cases, this may result in what one may term a "fire sale" price. For a going concern, on the other hand, replacement cost would be a more appropriate measure. In other words, what would it cost to replace the same equipment? Replacement cost can be difficult to assess. As an example, consider the practitioner who has included, in a sale, his well-maintained twenty-year-old x-ray unit. On the one hand, a similar machine depreciated for twenty years cannot be found. On the other hand, its value may be the same as or greater than a newer unit because of its workmanship and features. Obsolescence also affects valuation for similar reasons. As an example, it may be difficult to find an appropriate replacement cost for an old computer. Remember, value in use is the key.

How does one arrive at an appropriate replacement cost? For inventories and supplies, using their purchase costs would be appropriate because of the turnover of the items within a year. For equipment, computers and furniture, there are a few approaches:

1. Book Value: This is the depreciated value from the financial statements. This approach is often used for its simplicity. On its own, it may be useful where the assets are not of significant value. However, extreme caution should be used. At a minimum, the original invoices for the assets should be available and depreciation policies and rates should be reviewed. Often, accelerated rates may be used for tax purposes. A review of the repairs and maintenance account on the financial statements for the previous years may provide a picture of both the maintenance and the degree to which those assets may be wearing down. Where there are significant modalities and rehabilitation equipment involved, this approach is insufficient because the margin of error becomes greater.
2. Replacement Cost New: An approach often recommended is to obtain prices from dealers for the listed equipment. The prices obtained are, in fact, the cost to replace the equipment–new. Certainly, in practical terms, it is a useful measure because it addresses the issue of the same equipment. On its own, however, it tends to overstate the value in most cases.
3. Replacement Cost Used: Although this would approximate fair market value, it is often the most difficult to determine. The lack of a large market for used equipment and furniture is partly the reason. This is not to say that one can't find used equipment—only that in valuing an existing asset, it is difficult to find one that is the exact age or condition. To deal with this issue, it is often useful to obtain an independent appraisal. This is particularly important with assets of significant or potentially significant value. For example, if real estate were part of the transaction, one would not hesitate to request an appraisal of the property.

LEASEHOLD IMPROVEMENTS

An asset that has many a practitioner confused is leasehold improvements.

Since the landlord owns the property, don't they ultimately own the improvements? Yes...and...no. The landlord may own the assets but the tenant owns the right to use those improvements during the term of the lease. This right to use the improvements has value because a purchaser would have to invest in their own improvements if they were to move into new premises. One method to arrive at a value would be to take the original cost and apportion it over the term of the lease. The remaining cost on the date of sale would be the value. From the purchaser's point of view, they should ensure that amounts were expended for actual leasehold improvements and not the recreation room in the vendor's home. An examination of actual invoices would be useful. Also, the lease should be reviewed to see who was responsible for paying for the leaseholds. Sometimes landlords will offer to pay for leaseholds as an incentive to attract tenants. From the vendor's point of view, aggressive tax planning, whereby leaseholds have been written off as repairs, can backfire on a sale. This is one reason why planning for a sale is critical.

Finally, two other issues can impact on the value of these assets: taxes and a corporation. Sometimes the value attributed to certain assets can give rise to unwanted tax implications, such as recaptured depreciation for the vendor or increased sales taxes for the purchaser. From the purchaser's point of view, the more value attributed to assets other than goodwill will result in greater tax savings over time, due to the accelerated rate of depreciation.

The corporation can impact the asset values because of the tax implications of using a corporation. A vendor who sells the assets out of a corporation will have to consider the additional tax cost of removing the proceeds from the corporation. We will address other aspects of the impact of a corporation in a future article.

Ultimately, the approaches used to value the assets specifically will depend on the situation, the types of assets, their significance to the overall sale price, and the information available. ▲

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