



# Who gets the accounts receivable?

**By Simon Palmer**

Glen is a 64 year old dentist who has owned his own practice for 40 years and is looking to retire. After a couple of months with his practice on the market he finds Michael, a 30 year old dentist with a few years experience who wants to buy the practice outright.

The two of them have the practice value and get a business purchase/sale agreement together from some examples on an internet site that they found through Google. They seem to agree on everything, the timelines, the price, the restrictive covenants and so they agree that they will sign the agreement tomorrow.

Glen goes home with a load off his chest and commits to his wife that they are leaving as soon as possible on the 6 month overseas adventure that they had always talked about.

On the day of signing a realisation hits Glen. There is a little over \$50 000 in patients outstanding invoices owed to the practice for work that Glen did. The agreement that they have created doesn't handle this.

Glen thinks about it and realises that there are three ways that he can handle this and while each has its advantages, each comes with its disadvantages or compromises too:

## **Option1: The buyer purchases the accounts receivable**

This model is ideal for Glen as the sale of the accounts receivable offers him a fast clean break from the practice and the ability to cash out immediately. This approach leaves him no open-ended accounting issues after settlement and he can relax on his upcoming holiday.

Does this mean that Glen simply adds \$50 000 to the practice asking price?

While Michael will realise that something needs to be done about the accounts receivable it is highly unlikely that he will pay the additional \$50 000 for the receivables for two reasons:

- a. Any buyer would have to suspect that a percentage of the outstanding invoices will become bad debts and will not want to pay for money that doesn't come in.
- b. Any buyer would realise that they would need to provide the resources involved in chasing and retrieving these outstanding invoices (phone calls, stationery, the wages of the staff member spending their time chasing the

outstanding invoices). The cost to the buyer of these resources should be factored into the purchase price of the receivables as well.

It will be difficult for Glen and Michael to agree on both the % of receivables that will go bad and the resources needed to collect the receivables. The price reduction for these factors will be a difficult negotiation that may not be able to be resolved.

**Option 2: The buyer collects the seller's receivables as an agent of the seller.**

Under this scenario, the accounts receivable remains Glen's property however Michael will take responsibility for collecting them. Michael will charge Glen a percentage of the amounts collected to cover the time and effort involved.

This method has advantages for both parties. For Glen, this option represents a way to recoup the accounts receivable (minus the buyer's cost of collection) with minimal effort on his part. It also allows him to go on the trip that he had planned. Michael on the other hand assumes none of the risk that he would have taken on if he had purchased the receivables.

The main disadvantage of this model is that Michael will not do as good a job collecting Glen's money as he will collecting his own for three reasons:

- a. Glen knows all the details of the work and oversaw the work. It is much easier to collect money owed for work that you yourself have done and have intimate knowledge of.
- b. Glen has a history and relationship with the patients involved. It may be easier for Glen to collect amounts outstanding from patients as he has a relationship/rapport with them.
- c. Michael doesn't have the same monetary incentive. Michael only gets a small percentage of the money he is collecting.

If there are any problems collecting these outstanding invoices, and a significant percent become bad debts, Glen will be kicking himself that he chose this option.

Another disadvantage of this model is that Glen and Michael will need to negotiate on the cost of collection that Michael will charge. This negotiation may be difficult.

**Option 3: The seller retains the receivables, collecting them outside of the transaction.**

This model is clean and uncomplicated. Michael will only be responsible for the accounts receivable directly relating to the practice's production after purchase.

Glen will be responsible for the receivables relating to the practice's production before the sale.

The compromises that Glen and Michael will have to make with this scenario are:

- a) If Glen wanted to make a quick clean break from the practice after sale it will not be possible until he has finished collecting his money.
- b) For Michael, a significant disadvantage of this approach is that it represents a break in the continuity for the patients of the practice that is not present in the other two models. Whenever a practice sale occurs the buyer usually wants as many points of continuity for the patients as possible in order to maximise the transfer of goodwill.

Under this model the patients may theoretically be chased for two invoices from the practice at the same time that have different company names and ABNs on them and need to be paid into different bank accounts.

### **Which model to chose**

Obviously the first lesson to take out of this story is to consult a lawyer whenever you need any legal agreement.

All three of these models are used when buying or selling a business and in the end the model chosen will boil down how flexible and reasonable both parties are in their negotiations and how good their negotiating skills are.

Accounts receivable is a loose end that must be addressed in the purchase agreement and resolved in order to obtain a smooth and successful transition.

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