Grant Thornton

Navigating M&A Disputes: Key Insights for 2024 and Beyond

Teaser Video Transcript

Clear Language Mitigates Disputes

And that is our best practice #1 clarify the methodology, have clear language, have accounting principal schedules, describe the intention of the parties in the calculation, working capital as well as cash and debt, the other key balance sheet adjustments within the agreement. And in any EBITDA or earn out methodology, it's best practice to always have these clear schedules describing the intent.

Some of the pitfalls we do see here are maybe just throwing in a schedule, a table of numbers, but then after the closing there's left to be determination of what was meant by the schedule of numbers. An illustration alone only goes so far to help mitigate the risk of dispute. Otherwise you left to figure out post closing between a buyer and a seller. How do we come up with this particular number later? So clear language specific accounting policies, your best route forward to helping mitigate that risk of dispute. Now what gets a little tricky with these is that they're going to vary so much deal to deal.

One can't just simply look at the schedule of accounting principles, copy and paste that into another deal in a different sector, different industry, different business, different application of gap. The example Tom gave earlier of our biggest red flag issue when it comes to post closing balance sheet disputes is AR reserves. Well, our best practice would be let's describe exactly how we come up with that AR reserve. And almost always it's going to vary business to business. Sometimes we'll see that the AR reserve is simply determined based on the CFO or the owner or an accounts receivable clerk looking at that AR Ledger any given month end and taking down that list and saying, well that good for it, that bad for it, that good for it, we should reserve 50% of this, oh, maybe it's 25% the next month.

That approach is management judgment and management judgment for accounts receivable reserves is perfectly allowable on the gap. But the tricky thing when you coming into an M and a process is that group of management are now going to be owned by the buyer after the closing. The person who was involved maybe is a different person. The buyer who's involved maybe has a different application. Maybe they look at it on a formulaic approach. There is no right or wrong answer when it comes to many of these reserves. It's just the commercially agreed solution and then also considering the consistency between that calculation and how one established the target working capital too.

From a balance sheet perspective, our key purchase price adjustments are adding cash to the enterprise value to the extent cash exists, subtracting debt from the enterprise value to the extent debt exists and adjusting for the closing working capital versus a target normal PEG figure of working capital. And one thing we hear all the time when we're talking about closing working cap and target working capital is apples to apples. If we based a target on a 12 month average of working capital in those 12 months, has GAP been applied consistently? Has GAP been applied? What was the methodology to derive those reserves during that historical period?

And then how can we clarify exactly, well, if we did it this way 12 different times to establish a target, how we also do it at closing, but there are perspectives of a buy to that maybe. Well, this is a bespoke exercise. We're going through this closing statement process. We have the benefit of hindsight in that closing statement preparation, want to look back at what existed at the closing with the benefit of looking at what gets recovered after the closing. There's an awful lot of subjectivity that goes into any specific accounting policy, but by having a clear hierarchy set forth within the agreement rather than a gap or gap consistently applied, instead going with a, we want to look at specific policy first, consistency with a specific set of financial statements, and then gap.