

Completion accounts in share purchase agreements – avoiding disputes

What are completion accounts and why are they used?

A buyer of a business will usually base their offer to purchase it on the most recent financial statements – typically audited/statutory accounts or unaudited management accounts. These accounts only show the historical position to the most recent accounts date, and there is usually a period before completion which is not covered by them. For this reason parties often agree to produce a set of accounts after completion made up to the date of completion, known as completion accounts. The purchase agreement will set out a method for adjustment of the purchase price after completion if the financial position as shown in the completion accounts differs from the expected position.

The most common price adjustments based on completion accounts include:

- **Net assets adjustment** – This involves determining the net asset value (NAV) of the company at completion i.e. the total assets minus the total liabilities, taking account of both fixed assets and long-term liabilities. The purchase price is then adjusted to the extent that the actual NAV at completion differs from an agreed target NAV figure.
- **Working capital adjustment** – This involves the buyer paying for any working capital in the company at completion which exceeds an agreed level of ‘normal’ working capital, or receiving a price reduction if working capital is lower than the agreed benchmark.
- **Net current asset adjustment (NCAV)** – All liabilities of the company are deducted from the value of its current assets only. Again, the purchase price is adjusted to the extent that the NCAV at completion differs from an agreed target NCAV figure.

It is important to establish what form of adjustment will be used, so that the share purchase agreement can accurately document this. Even though each party will usually engage their own accountant to assist behind the scenes in the compilation or review of the draft completion accounts, the process can take several months to conclude and the final purchase price will not be known until the completion accounts have been agreed or determined. It is common for delays and disputes to arise in respect of the process and calculations.

Agreeing a clear process

The risk of disputes arising can be reduced by making the terms of the purchase agreement as clear and certain as possible by addressing the following:

- The parties should try to agree a completion payment which reflects a reasonable estimate of the target company’s financial position at completion so that cash flow issues and the risk of non-recovery of the further amount is reduced.
- The form and content of the completion accounts – these can take a variety of forms, including:
 - A full profit and loss account and balance sheet
 - A balance sheet only

- A net assets statement
- A valuation of a specific asset.
- The accounting standards and methodology to be applied in their preparation – this will have an impact on the matters included in the accounts and the values attributed to them which, in turn, will affect the amount and, in some instances, the direction of the resulting price adjustment.
- Any specific policies to be applied for example in relation to bad debts, stock and asset valuations and depreciation of property.
- The period covered by the completion accounts – typically this will be the date to which the company's last accounts were prepared, to the date of completion. It may be appropriate to effect completion on the company's accounting month end and to agree a particular time of day at which the line will be drawn for the purpose of preparing the completion accounts.
- The timetable for preparing and agreeing completion accounts – typically this will involve a first draft of the accounts being drawn up by one party by a set date (usually 3 to 4 months after completion), following which they will be sent to the other party for review, again, within a specific period set out in the purchase agreement. These are then either agreed or objections raised concerning the basis of preparation or any of the sums included in the draft accounts. If any objections are raised, there usually follows a resolution period for the parties to try and resolve the issues by negotiation.
- Sanctions if either party fails to adhere to the agreed timetable – if for example the preparing party fails to deliver the draft accounts by the agreed backstop date, the reviewing party could be given the right to prepare the first draft itself, possibly at the defaulting party's expense. In relation to the recipient's review of the completion accounts, an effective sanction is to provide that the draft completion accounts will be deemed to be agreed if the recipient fails to notify the preparing party of its objections within the specified review period.
- A contractual right of access to information for the seller after completion.
- A right for the reviewing party to review the working papers relating to the draft completion accounts so as to understand how the figures have been derived from the relevant underlying financial records.
- How the price will be adjusted by reference to the financial information shown in the completion accounts.
- When any adjusting payment will be made and how it will be satisfied. Once the actual purchase price is determined there will then be either a further payment to the seller, or a repayment by the seller to the buyer to the extent that the provisional price falls short of or exceeds the finally determined purchase price.
- To help reduce any immediate cash flow advantage to either party of prolonging the completion accounts process, it may be agreed that the buyer pays a provisional sum on account of the purchase price into an escrow account at completion to be held there until the completion accounts have been agreed, then funds can be released to the relevant party accordingly. Again, it is important that the purchase agreement and accompanying escrow paperwork clearly sets out the process for the release of any escrow funds.
- The procedure for resolving any disputes – if the parties cannot agree the accounts via negotiation, agreements usually specify that unresolved matters are to be referred to an independent expert accountant for final determination.

Accountant involvement

Both parties should involve their accountant at an early stage in the transaction. The seller's accountant should circulate a draft completion balance sheet for the company as soon as possible so that the buyer and the seller can have an estimate of the likely eventual purchase price adjustment. This allows the buyer to understand its cash flow requirements for the transaction and the seller to be aware of the likely amount of sale proceeds.

Both the seller's and buyer's accountants will need to review the schedule in the purchase contract that deals with the procedure for the preparation of the completion accounts, the accounting policies and principles to be

applied and the format of the completion accounts in order to advise accordingly.

The accountants will need to confirm whether there are (or will be at completion of the sale) any outstanding director's loans/balances, whether they are debtor or creditor items in the balance sheet and how these balances are to be dealt with in the purchase contract.

Tips for avoiding and dealing with disputes

- All parties should read and understand the terms of the purchase agreement in terms of the completion accounts process and familiarise their accountant with them (as above).
- Diarise the timetable and set reminders allowing sufficient preparation time for each stage.
- It is important to adhere to the timetable in order to avoid any sanctions of not doing so.
- The party providing the draft completion accounts should make sure that they comply with all of the requirements in the purchase agreement and that all necessary documents such as NAV calculations and supporting working papers are provided within the specified periods.
- Any objections to the draft accounts should be raised promptly by the reviewing party or their accountant and before the deadline in order to avoid the risk of being deemed to have accepted the drafts.
- The parties should keep communicating with each other – if a deadline cannot be achieved this should be communicated and the parties could seek to agree a new timetable.
- If a deadline is missed by the other party, act quickly to notify the defaulting party and refer to the sanctions in the purchase agreement.
- If the other party is no longer cooperating, seek legal advice as to the best way forward, which might involve a formal letter reminding them of their obligations and threatening further action if progress is not made.
- Although the agreement will often provide for disputes to be referred to an expert accountant for determination, bear in mind that this can be very costly and cause further delay so it is usually in the parties' best interests to resolve any disputes without resorting to a formal dispute resolution process.



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