PRACTICE MANAGEMENT

Private equity eyes accounting firms large and small

Private-equity investors are increasingly buying into accounting firms. The deals, which carry risks and benefits for the profession, change the way the firms operate.

By Andrew Kenney

The first time she got a cold call from a private-equity investor, Paula Waggoner-Aguilar, CPA, was mystified.

"We're a small advisory and consulting firm, we stay in our niche, we don't advertise a lot. Our energy and health care businesses are very word-of-mouth," said Waggoner-Aguilar, who with her husband co-owns a fractional CFO and financial analysis service business called The Energy CFO and its subsidiary, The Healthcare CFO, in Texas.

"I'm like, 'Why are you calling me?'"

But the calls kept coming. Since last year, the couple have heard from four potential investors

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who want to buy into the business. Waggoner-Aguilar wasn't interested, but the proposals made her curious.

She soon learned that private-equity investors have been buying their way into the world of accounting, planning, and advisory services — a push that has spread since 2021 to some of the country's largest public accounting firms.

Waggoner-Aguilar realized these outside investors had "a completely different perspective" than she and others in the profession did, she said. They saw an opportunity to use surges of investments to grow firms more quickly, she thought — in ways that accountants have perhaps not embraced.

She wondered: "Is this the new trend?"

Notable new private-equity deals began to surface in August 2021, when TowerBrook Capital Partners announced its investment in EisnerAmper, an accounting firm that employs more than 3,000 people globally.

Similar announcements have followed for the large firms Citrin Cooperman and Cherry Bekaert, and other investors have set their sights on firms and consultancies of all sizes. As the head of Koltin Consulting Group in Chicago, Allan Koltin, CPA, CGMA, has been an adviser at the center of some of the largest recent deals. Koltin said he is in talks with dozens of groups about private-equity deals, and he projected that as many as six of the largest accounting firms will strike deals by mid-2023, along with countless smaller firms.

"Of the top 20 [public accounting] firms, more than half of them are in some type of transformative discussion — and a big part of that transformative discussion involves private equity," Koltin said.

WHY PRIVATE EQUITY IS INTERESTED IN ACCOUNTING

Investors have eyed the accounting world for years. But these deals have come to fruition in recent years because private equity now sees accounting as an ideal market for growth.

"We saw an opportunity that is similar to ones that we've seen in similar markets, like wealth management, like insurance distribution," said Andrew Dodson, managing partner of Parthenon Capital, which announced its investment in Cherry Bekaert this June.

As with those other professional service-based businesses, the accounting market is "super highly fragmented," Dodson said, with tens of thousands of firms arrayed across the country. That is enticing for investors, who see an opportunity to build "platform" firms that can then acquire their smaller competitors. In short, they see an opportunity to become market leaders in spaces that aren't controlled by large, dominant players.

Just as important, it is a market facing transformative changes. Large accounting firms are seeking money infusions to conquer the biggest challenges facing the profession: talent, technology, and growth.

"We think that for firms to thrive, they need to make investments in people and technology, and, obviously, regulatory adherence, to really differentiate themselves in the market," Dodson said. "And that's going to require scale and capital to do it. That's what gets us excited."

As with other deals described in this article, the partners in the Cherry Bekaert deal have not disclosed the details of the investment, including

IN BRIEF

- Private-equity investors have eyed the accounting world for years because they see accounting as an ideal market for growth. In the past 18 months, several accounting firms struck deals.
- A private-equity deal requires a firm to restructure. Regulations stipulate that audit firms must at least be majority-owned by CPAs, which disqualifies most would-be private-equity owners. One option is to split the firm into two organizations.
- A private-equity deal also comes with a change in financial rewards and payouts, which tends to benefit senior partners. But it also introduces new financial risks and requires a laser-sharp focus on independence and professional standards.
- Firms that accept private-equity investments anticipate that accelerated growth projections go hand in hand with a larger technology budget and improved retention and recruitment.
- Negotiations between more firms and investors are ongoing, but future deals will likely be influenced by how investments that have already been made shape up.

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the amount invested or the size of the stake now owned by the investors.

Accounting leaders, including those involved in these deals, say investments are especially needed to get ahead of the automation and offshoring trends that are reshaping audit and compliance.

"We have a declining revenue base in compliance," Koltin said. And automated software is expected to lead to a race to lower costs: "The feeling is technology is going to cause evaporation of our revenues," he added.

Accounting firms need capital to make efficiency-minded investments in robotic process automation and machine learning, as well as offshoring of their services in some cases, to counter that revenue loss, Koltin said. But many also want to diversify into advisory and consulting — which, once again, takes money.

Meanwhile, firms that have taken private-equity investments are racing ahead with mergers and acquisitions.

"The profession has been moving toward consolidation for a lot of years now. The pressure and intensity on mergers have been growing for the last four or five years. This is a continuation of the trend," said Charly Weinstein, who previously held the traditional accounting leadership title of managing partner at EisnerAmper LLP. After the firm was restructured during its private-equity deal, he became CEO of Eisner Advisory Group LLC, the larger group that handles the firm's nonaudit activities.

Barry Melancon, CPA, CGMA, president and CEO of the AICPA described the private investments as a sign of promise for the profession, but he added that the opportunity has to be approached with caution and an eye to maintaining quality of work.

"The fact that private equity is interested in the profession is a statement about the importance of the profession. That's a good third-party validation," Melancon said in a written statement. "We are seeing lots of private-equity activity but also tremendous numbers of traditional merger deals among firms. This demonstrates choice and different approaches for firms, which is always good as long as the focus on quality remains paramount."

SUCCESS IS NOT ASSURED

Despite the flurry of high-profile investments in large firms, the true influence of private equity on the profession's future is far from clear. Initial investors — and many current employees of the firms — are hoping to make a profit when the investors sell their stakes again in the future. But it won't be known for several years whether the firms can grow enough to make those future sales happen at desirable prices, said Gary Shamis, CPA (retired), CEO of Winding River Consulting.

"It's far from a sure thing," said Shamis, who built a large CPA firm and sold it in a merger with another CPA firm. He recounted that outside investors have tried and failed with significant investments in the accounting profession in the past.

In the mid-1990s, publicly traded companies like American Express and H&R Block tried to break into the accounting world — generally with disappointing results. And while new interest is brewing today, Shamis is skeptical companies will be able to hit the ambitious growth targets that likely come with a private-equity investment.

"You just don't know if they'll be able to be successful, and history shows some pretty smart people in the past have tried to do it and weren't successful," he said. "So, do they have a better model?"

In an August 2022 statement, Paul Munter, acting chief accountant of the SEC, wrote that accounting firms that receive investments from private equity must exercise great caution.

"[C]omplex transactions with investors that ▶

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> ‘The profession has been moving toward consolidation for a lot of years now. The pressure and intensity on mergers have been growing for the last four or five years. This is a continuation of the trend.’
>
> **Charly Weinstein,** CEO of Eisner Advisory Group LLC

are not traditional accounting firms and have not previously been subject to the same independence and ethical responsibilities,” he wrote, “elevate the risk to an auditor’s independence.”

Private-equity firms, he wrote, are often complex, and accounting firms should carefully investigate all entities associated with private-equity firms they partner with to avoid possible threats to independence. They must also, he noted, take care to communicate their responsibilities “in the way of auditor independence and professional ethical behavior” to their private-equity partners.

HOW FIRMS CHANGE AFTER PRIVATE EQUITY BUYS IN

Joel Cooperman founded Citrin Cooperman in 1979 with just one other partner; their primary clients were the rock bands The Who and Yes. The firm has grown since then to about 1,800 employees and 20 locations in the United States and India.

In the fall of 2021, the firm announced it had sold a majority stake to New Mountain Capital.

Citrin Cooperman had considered a similar deal in 2020, but those negotiations ended without an agreement, as the firm came to believe it would not be a good fit, Cooperman said. This time, though, Cooperman believed New Mountain would be a “great partner” and the right investor at the right time.

“What was going through my mind: Would this be good for our current and future partners, for our staff, and for our clients? And how will it impact the culture of the firm going forward?” he recalled.

After the deal, the business had to restructure, which must happen with practically any private-equity investment in a public accounting firm. Regulations stipulate that audit firms must at least be majority-owned by CPAs, which disqualifies most would-be private-equity owners.

To remain in compliance with regulations, firms partly owned by private-equity firms may adopt an “alternative practice structure,” which splits the firm into two organizations. Audit and attestation services remain with the original firm, which is owned by CPAs. The rest of the business is moved to a new, larger company, part of which is sold to the private-equity investors.

Cherry Bekaert and EisnerAmper implemented similar structures with their deals. Michelle Thompson was managing partner of Cherry Bekaert LLP before the firm’s deal with Parthenon. She now is the CEO of Cherry Bekaert Advisory LLC.

“The former LLP still exists. That is where the CPA licensing and regulation is handled, that’s where our attestation business is. It has to have CPA ownership,” Thompson said. “And then the advisory firm has the rest of the business: consulting, tax, risk advisory, our digital transformation business.”

The corporate rearrangements also come with a revamp of the partnership compensation model. Traditionally, accountants at public CPA firms work toward a partnership that rewards them with a multiple of their salary to be paid after retirement, perhaps over 10 or 15 years without interest and taxed as ordinary income, according to leaders of the firms involved in these deals.

In the new deals, partners can receive immediate payouts and rollover equity that can increase in value if the firm grows and eventually transfers ownership to other private-equity groups. The partners in these deals generally expect that the original investors will sell their stakes at a profit to a new investor in a matter of three to seven years. The new model can also include management incentive units for partners and staff and other ways to deliver near-term rewards for company performance.

Partners "still operate the business. We still have to plan for success, we still have growth, and we're looking for talent that stays," Thompson said.

But the investment deals create a new draw for young partners, she said. Instead of waiting for a financial reward at retirement, under the terms of the deals, they could instead see a payout in just five to 10 years, assuming the firm's leaders can arrange another sale to investors. She expects those future sales will happen in five to 10 years.

"You participate in the ability to create value every five or so years [through potential future investments and sales]. You can see a transaction that has a liquidity event for you every five or 10 years — as opposed to waiting until you're 65," Thompson said.

The switch away from deferred compensation is having an immediate effect on hiring and retention, according to Koltin. Young finance leaders are attracted to the potential for shorter-term profits that mirrors how tech industry executives can make major profits on stock options if a company is successful.

"In just the first year, I've watched them compete against the 10 biggest firms in the country for talent, and they're winning a lot more than they're losing," he said of EisnerAmper and Citrin Cooperman. (Cherry Bekaert had only recently struck its deal at the time this article was written.)

But the shift away from deferred compensation carries risks, Shamis said.

Compared to more senior partners, junior employees aren't getting as large a payout when the private-equity deal is completed. Instead, their profit will depend in large part on the company's ability to grow the firm and complete that second transaction — all while working alongside the investors. And there's always the risk that growth-oriented financial benefits don't pan out.

"The retiring partner sees a lot of dollar signs, and then the rising partner has a lot of question marks," Shamis said.

He added that firm leaders have other options to access capital needed for investments, such as bank loans.

"You're selling your company to get this access to capital," he said. "I'm not so sure that that's the only solution for capital moving forward."

ACQUISITION SPREES AND TECHNOLOGY UPGRADES

Since the first deals were inked last year, firms have moved to add new staff, capabilities, and capacity.

That's not just because they have new money to spend. It's also happening because the firms are moving away from the decision-by-committee approach that can happen under the partnership model, Koltin said.

"So, now you move it to more of a corporate decision-making process. And you make a lot more decisions on a lot tougher things, and you make them a lot faster. You make deep investments," he added.

For example, Citrin Cooperman and its new private-equity partners have spent a significant sum to study the firm's technological needs.

"It's not just a haphazard approach to using technology. We're doing a full-scope, in-depth analysis to figure out how we better use automation and technology inside our organization," said Alan Badey, CPA, CGMA, the CEO of Citrin Cooperman Advisors LLC. "We would have never done that before."

Similarly, EisnerAmper has raised its ▶

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Allan Koltin, CPA, CGMA, the head of Koltin Consulting Group in Chicago

technology budget from $18 million to $30 million, Weinstein said. Citrin Cooperman also is revamping its sales function and creating a dedicated team to develop new business, though it will still expect everyone in the firm to keep looking for sales opportunities, the firm’s leaders said.

Meanwhile, these investment-powered firms are racing to snap up smaller firms, as well as technology companies and others, according to their leaders.

“The question is the speed now — and the speed is going to be faster,” Thompson said. She added that since private-equity groups are focused primarily on investing in other companies and helping them grow, they can help accelerate these mergers.

“The private-equity partner can bring some expertise to that speed and really help you smooth out some rough edges,” she said.

Citrin Cooperman has inked seven deals under its new model, with another three in the pipeline as of the publication of this article — compared with roughly 50 that Joel Cooperman had completed in the previous four decades. That’s about $100 million of completed transactions in a year, he said, compared with a goal of $150 million over five years set by investor New Mountain Capital.

EisnerAmper also has completed 10 mergers since last July, with another four or five in the pipeline, Weinstein said. These acquisitions are building the firms’ traditional accounting business and adding significant depth in technology and consulting services, he said.

“Technology services, valuation services, cybersecurity services — all those types of advisory services which were typically more upmarket, over the past 10 years, they have all come down into the middle market and the lower-middle market,” Badey said.

In other words, there’s growing pressure for middle-market firms to offer a wide array of services, and private-equity groups hope to grow the accounting firms they’re investing in by adding those services.

WHAT DOES THIS MEAN FOR THE FUTURE OF ACCOUNTING?

With new investors comes a new set of expectations for individual firms and the profession at large. While the accountants have retained leadership roles, the new deals have them sharing that power with investors.

Before, Badey said, “We weren’t reporting to shareholders. We weren’t reporting to any of these outside people. Now we are.” It’s an adjustment, he said, but he thinks the changes will benefit the company.

“One of the things that I never realized was the financial rigor that goes on inside a private-equity company,” Badey said. While accounting firms are known for their skills in bookkeeping and their financial acuity, he said the new investors have brought a sharper eye to aspects like financial planning for the firm itself.

“We are definitely getting more and more financially astute. … We’ve gone out and we’ve hired a CFO with big-company experience. We’ve hired FP&A people, hired a controller,” he added, saying the internal finance team has become “very substantial.”

The prospect of private-equity ownership also raises risks, as Shamis and others pointed out. In some industries, outside investors have a reputation for instituting ruthless new cultures that value growth above all else or achieve profits by slashing spending. That kind of profit-driven tunnel vision isn’t compatible with businesses like accounting that rely on dedicated knowledge workers, Koltin said.

“Having talked to close to 100 private-equity groups, there’s one-third that don’t have demonstrated track records of understanding businesses where the assets [their employees] go home every night — professional services firms. That group, they would not be successful," he said. "The successful ones understand the importance of people. They're not going to micromanage."

Instead, he said, an investor should act as "your highest-level strategic and capital partner." That means investors generally won't be closely involved in the traditional accounting practice — but they will use their substantial influence within the firm to set goals for growth and resource allocation.

Accounting firms also must be careful as they grow their services and scale, whether or not it involves private equity, to respect rules meant to encourage independence in auditors, according to Melancon.

"Private-equity deals for firms require firms and leadership to be extra focused on independence and standards of the profession. The profession is attractive because of its competency and the trust it has built in the market. Firms in this environment have to prioritize tone at the top on ethics, independence, and trust. Commitment to those concepts creates the value and, regardless of structure, has to be a priority," he said.

Citrin Cooperman ensures the profession's independence rules are followed by relying on its chief risk officer, Patricia Cummings, and her sizable team, including the firm's Office of Independence, which reviews new clients and conducts robust independence and background checks, Cooperman said.

And, overall, the accounting executives in these deals said concerns about private-equity partners are real but manageable. It's paramount, they said, to find the right investors.

"You need to make sure your investor has a thesis in the space," Thompson said. In other words, investors should be well versed in the accounting profession, with a specific plan for how their investment will help a company grow. "It shouldn't be 'This looks interesting.' They need to understand our industry."

WHAT TO EXPECT NEXT

Negotiations between more firms and investors are ongoing, Koltin said. But future deals will likely be influenced by how investments that have already been made shape up.

Cooperman projected that many of the top 200 firms will either take investments or be acquired by a larger, equity-backed firm in the years ahead. And if those investments are successful, the firms soon will attract even larger investors, who may buy out the current round of private-equity players, Koltin said.

But all that depends on whether these firms can grow at the rates expected by investors, Shamis said. The profits of both the investors and current partners will depend on whether the firms can attract a second set of investors in the future. There's initial interest now, but the deals are predicated upon the idea that the firms can grow fast and justify even larger investments in a future deal.

"What are the exits going to be? Who wants to buy a $1.5 billion CPA firm?" he asked, referring to a hypothetical future valuation for firms that struck deals. If there's no buyer waiting, a firm's partners might find themselves buying the organization back from their investors — as "damaged goods," he said.

The outcomes just aren't clear yet, Shamis added. "I think you're going to see more firms do it. They don't want to miss out, so I think you will see the acceleration pick up. But we're not going to know any answers until five years down the road."

Meanwhile, the same tidings of change are seeping out even to the smallest firms and consultancies, where the managers of much smaller investment groups are reaching out to potential partners like Paula Waggoner-Aguilar and her family business in Texas.

"When it started, the large private-equity firms were only interested in the top 20 accounting firms," Koltin said. Now, he said, he's hearing from smaller private-equity firms and individual family offices looking into accounting firms that have revenue in the range of $10 million to $150 million.

For now, Waggoner-Aguilar doesn't want to join the trend.

"I'm still very young and focused on building my own business," she said. Waggoner-Aguilar is a former global energy finance and accounting executive who left the corporate ranks to focus on private, middle-market companies almost a decade ago. Seeing the interest in her business was both flattering and intimidating, she said, since it signaled a larger restructuring was underway that could upend the profession.

"They're talking to plenty of firms. I know I'm not the only one," Waggoner-Aguilar said. Friends and colleagues have heard from investors, too — and many more accounting businesses, large and small, may soon accept the offer of investment and the changes it brings. ■