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Capital vs. control: PE's impact on CPA firms

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Private equity's growing presence in the accounting landscape has given rise to a substantial inflow of capital opportunities, empowering firms seeking to expand into new markets or deepen their presence in existing ones. Despite all the up-front benefits of non-bank lending, accountants can't help but wonder about the true cost of going down this road.

Firms like Top 25 Firm Armanino LLP and Top 50 Firm Cohen & Co. have recently joined the ranks of the many who have taken on PE investments since 2021, when the deal between Top 25 Firm EisnerAmper LLP and PE firm TowerBrook Capital Partners set the stage for other investments to follow suit. While the idea of such a deal had been mulled over for several years beforehand, the investment in EisnerAmper is generally understood to be the first of its kind to come to fruition.

This year alone, EisnerAmper has used the funding to support four acquisitions: Tidwell Group, Edelstein & Co. LLP, Krost CPAs and Tighe, Kress & Orr PC.

Philip Whitman, CPA and CEO of advisory firm Whitman Transition Advisors LLC, said PE activity has only grown since that first investment, with 2024 being the year that investors have become more eager to invest in or partner with CPA firms.

"To date, our team has met with over 150 private-equity groups that have a desire to find foundational firms in the accounting/CPA firm arena. … Not a week goes by that I am not hearing a pitch or new thesis by at least three or four private-equity groups that are considering entering the accounting-firm space," Whitman said.

While the money itself is a welcome addition for firms of various sizes, the conditions it could bring are less so — independence being the first such condition that could change following PE investments.

1/2 Examples of various deals between CPA firms and private equity investors broken down by transformation type. (Allan Koltin)

2/2 More examples of various deals between CPA firms and private equity investors broken down by transformation type. (Allan Koltin)

Firms that provide attest services must be majority-owned by licensed CPAs, but still allow for a minority stake to be owned by non-CPA entities. New York Governor Kathy Hochul signed a non-CPA ownership bill into law late last year, making New York the most recent state to allow "public accounting firms with minority ownership by individuals who are not CPAs to incorporate in New York State," according to a press release.

As is often the case, PE transactions will result in a firm being divided into two entities, one owned by CPAs to oversee attest services, and the other wholly or part-owned by non-CPA private-equity partners that provide non-attest services such as tax, technology or consulting services.

Experts stress the importance of a clear distinction between which parts of a firm are owned by CPAs and which are not, both from a legal standpoint and a client relationship perspective.

"My understanding is that the PE firms have a bit of a workaround, with those employees and transferring income, but I feel that could be a very fine line or walking on thin ice," said Stephen Mankowski, owner of the Pennsylvania-based accounting firm Mankowski Associates CPA. "Firms need to be independent both in fact and appearance. … The PE firms cannot have a relationship with any clients of the CPA firm."

Even with those divisions, PE groups "putting tens or hundreds of millions of dollars into an organization will want a say" in how the broader organization is run, said Mark Masson, managing partner and head of professional services at the Chicago-based Lotis Blue Consulting.

"It may look collaborative at first, but what does it look like six to 18 months in when you hit a bumpy patch?" Masson said.

Firms that can navigate those dilemmas gain access to a pool of investors hungry to dive into the world of accounting, promising vast funding for M&A strategies, technology investments, and.

"PE has raised the 'performance bar' for CPA firms by moving them from a 'country club' culture to a 'country' culture. … Specifically, they have instilled a culture of greater accountability (less autonomy) and hence a higher-performing firm over the 'hold' period," said Allan Koltin, CPA and CEO of Koltin Consulting Group.

Read on to learn more about the growing presence of PE in the accounting profession, and how experts are keeping a close eye on the promises and pitfalls of new investment activity.

Allan Koltin at the 2024 PE Summit

The unequal impact of private equity in accounting

The influence of private equity and the much-needed capital it brings has been steadily growing across the accounting profession over the last few years. But seasoned professionals say that while it works for some, it's not a cure-all.

"Private equity is not a silver bullet," Allan Koltin of the Koltin Consulting Group told attendees at Accounting Today's inaugural PE Summit, held in late November. "If you don't do PE, that doesn't mean you won't be successful. But you do need to figure out what you're going to do" to solve the issues of access to capital and resources that PE deals help with.

The values of PE are seemingly only an option for the higher-earning firms, Koltin explained, as the scrutiny of PE firms where earnings reviews are concerned is a high bar to clear.

"It seems like a lot of deals have happened, but believe me, the same number or more have died," Koltin explained.

The private equity changeup in accounting career pathing

Private-equity investments, outside the obvious capital benefits, are repathing traditional career tracks across the accounting profession, according to a recent report.

The Accounting MOVE Project says PE is "challenging long-established firm structures" and "raising significant questions about the future of ownership models and their impact on career development," according to a report it recently published. The report was co-sponsored by the Accounting & Financial Women's Alliance and Top 100 Firm Moss Adams.

Career pathing has been a particular point of contention for many firms seeking to enlist fresh talent amid a growing shortage of new graduates. The report goes on to explain how PE buyers use structured opportunities for advancement within firms to incentivize retention.

Allan Koltin (middle) at the 2024 AICPA Executive Roundtable

Private equity is the beginning of a new era. Is it a good one?

Accounting has undergone numerous changes over the last four years, as private-equity firms have continued to grow in scale and number throughout the profession. Experts like Matthew Marinaro, a principal at PE firm Red Iron Group, say if this trend were likened to a baseball game, "We're in the second or third inning."

These partnerships have become prevalent in various forms, according to Allan Koltin, speaking at the AICPA Executive Roundtable in New York in September.

Models include instances of PE firms acquiring a piece of a Top 25 Firm to then provide capital for buying up smaller Top 500 firms, as well as more broad purchases of Top 30 to Top 100 accounting firms by middle-weight PE players.

Revenue quality — not just quantity — is key

Those at the heart of the growing trend of M&A in accounting say recurring revenue is an important factor in any private-equity deal, but it's revenue quality over quantity that will win out in the end.

One such person is Jason Slivka, a corporate development partner with Top 25 Firm Citrin Cooperman. His firm has executed at least seven notable acquisitions this year alone, including Coleman Huntoon & Brown PLLC, Mibar, Maier Markey & Justic LLP, S&G LLP, Teplitzky & Co. PC, Signature Analytics and Clearview Group — all stemming from funding it received in 2021 from New Mountain Capital.

While speaking at the Scaling New Heights conference in Orlando, Florida, this year, Slivka explained that his "holistic" approach to evaluating possible acquisitions starts with culture, then works its way outwards towards financial metrics.

"We will want to understand how they have managed their business throughout its course, so we can understand its culture and people," he said.

The private equity 'revolution' comes with risks

Private equity is having its moment in wealth management and accounting, following a significant drop off in deal activity by volume and value in 2023 when compared to the prior year. Experts remain wary, however, that capital options from nonbank entities could yield unforeseen risks.

In Top 100 Firm Cherry Bekaert's most recent annual report on leveraged buyout deals, experts highlight how the higher interest rate environment present over the last few years drove up capital costs and pushed many towards alternative funding sources. This growth in the private-credit market has positioned PE firms as "the primary drivers of private credit consumption" but haven't alleviated concerns of a growing PE bubble, the report said.

"As investments have begun to take shape and private equity demonstrates its ability to drive transformational growth and improve financial performance in people-heavy businesses, the hesitation has become less concerning," the report said. "CPA, consulting and wealth management firms appear to be in the midst of a private equity-backed revolution."