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What Private Equity Means for Accounting Firms: Thought Leaders Explore Pros and Cons

Private equity firms have been increasing their investments in accounting firms. What does this mean for the future of the profession?

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In the past several decades, few topics have driven as much conversation among accounting professionals and firm leaders as has ongoing private equity investment in firms. This phenomenon has caused the profession to rethink the very model of firm ownership, success, partnership and hierarchy. It's definitely not the model of firm management that your mother or father experienced or envisioned, if they were an accounting professional.

The recent push by private equity firms towards investment and ownership of these professional practices is a sign, at least, that they see the potential to make profit in this area. This can either mean that they believe this market is intrinsically positioned to grow, or that these practices are missing blatant opportunities for revenue expansion. In many cases, the answer is likely a combination of the two.

In brief, the concept of private equity investment is basic capitalism. A group of investors buys a controlling stake in a business as an investment, for the purpose of realizing gains from that investment when sold typically 3-5 years later. Of course, all firm founders have a goal of making profit, and the traditional partner role is built upon an equity stake model, but over a long and often undefined term. With private equity firms, however, the investors are generally not professionals in the specific field of the business they acquired, and usually have a short-term goal of selling the business for a profit.

To have a controlling stake in a firm, the PE investors must take greater than 50% ownership. They often focus their efforts to maximize the eventual sales value of the acquired business via a combination of targeted acquisitions of other firms, capital investments, expansion into profitable niches, waste reduction, tech adaptation, streamlining and other measures.

However, there are complications. Audit firms cannot be owned and operated by non-CPAs, therefore firms that accept majority outside investment, or are hoping to attract it in the future, generally must organize their audit/attest practice independently from their tax/advisory/consulting side, allowing for PE investment in the latter.

The first major deal by a private equity firm to acquire controlling interest in a top 20 accounting firm happened as recently as 2021, when TowerBrook Capital acquired EisnerAmper's tax and consulting practice for an undisclosed amount. Since then, several more top 100 firms have sold to PE firms, and firm acquisition experts like Allan Koltin, CPA, who advised on the EisnerAmper deal, see this trend increasing.

In March, two dozen of the profession's thought leaders met virtually as part of Avalara's Accounting Meta Influencers roundtable, where they identified and discussed how private equity may impact the profession, from not only the largest firms, but potentially even mid-sized and smaller practices. The event was moderated by Dan Hood, editor-in-chief of *Accounting Today,* while *CPA Practice Advisor's* editor-in-chief Gail Perry, CPA, joined as a panelist, and its managing editor, Isaac O'Bannon, observed.

The State of Accounting Firms and PE

Hood opened the session by noting the extent to which PE activity has been occurring in the accounting space recently, and introduced Koltin, who has been involved with dozens more PE deals since the EisnerAmper acquisition, including several top 30 firms.

Koltin provided the participants with a primer on PE in the profession, including why it has become more frequent in just the last couple of years, and where he thinks it will lead.

"The accounting profession has been in existence for 135 years, and for the first 132 years, it was steady Eddie," he said. "Firms had two products, financial statements and tax, and then some went down the path of advisory and wealth management. The profession is now transforming due to factors such as AI, commoditization of tax services and other technologies, and capital from private equity investments can help in this transformation, and also help in the war for talent."

Another interest for firm leaders, Koltin said, is that the current partnership model is built upon a risky premise of, "Come join us. You get nothing at first, you'll have to revest. And in 10, 20, or 30 years from now, when you're 65, if you're still alive, if the firm is still here ... we'll pay you two times your earnings as ordinary income over 10 years, with no interest. That's only like 50 or 60 cents on a dollar." PE firms, on the other hand, see accounting firms as having much greater value and are willing to pay principals handsomely.

Koltin said he classifies accounting firms in three ways, when it comes to their preparedness for the changing profession. There are those that are oblivious to the change and will just continue with the same services. "Another group of firms sees changes in the wind but can't execute a strategy because they have a dysfunctional partnership model." And a third group that is proactively expanding and diversifying services.

Over the past two years, Koltin said he has signed engagement letters with 50 PE firms, and so has a good understanding of the trends. What size accounting firms are private equity groups eyeing? Koltin said about a third look at top 25 firms with revenues at $300+ million. But even firms in the $50-100 million range are being actively targeted, and Koltin has seen firms with under $10 million revenue being acquired.

Thought Leaders Discuss PE

Following Koltin's explanation, Dan Hood guided the group initially through a Q&A with Koltin and then open discussion of various topics related to PE investment, and asked the group whether they thought of PE as an opportunity for firms, and how it might impact various practice issues, including staff retention.

Jennifer Wilson, founder of ConvergenceCoaching, was the first to ask Koltin for further explanation. "Change is absolutely necessary for the profession," she said. "But regarding the success of PE investment, which requires the investing firm to later sell the acquired accounting firm at a profit," she asked, "Have any of these PE deals been flipped yet? Do they flip to venture capital, or to another CPA firm? Or is this smoke and mirrors? A big pile of money for older partners, but it might chain remaining staff to a top-line focus to double in size by acquiring firms that may have problems. I don't know that PE is the big panacea."

Koltin responded, saying, "I think there will be a strong market for these firms ... but we can't even imagine who the ultimate buyer will be. Elon Musk owns an interest in a tax and consulting firm. Microsoft is also in the business. But it will only be the highest-performing firms that are desirable to private equity."

Blake Oliver, CPA, who was in the small CPA firm world but left prior to founding CPE provider Earmark, asked how this will affect non-partner managers and staff. "What is it going to be like to be a staff member in these firms, and what is the opportunity for you as a manager in the future?" Oliver is also cohost of the Cloud Accounting Podcast.

Koltin replied, "The monetization takes away deferred comp, but I think it's the need for capital for the areas of transformation, technology and talent that PE provides that helps build the firm of the future. Firms have choices. They can do it on the cheap, they can ignore, or they can truly transform. But financially, staff members also can receive A, B and P shares, management incentive units, stock options, rollover equity. They can get these at an early age where they can get a bite of the apple themselves."

Eide Bailly's Jenni Huotari, CPA, agreed that young professionals can view the partner model as a Ponzi Scheme, and fewer staff are staying and buying in.

"The significant growth you've seen from the likes of Citrin Cooperman and EisnerAmper, is that from a diversification of product service lines or growth within offerings they already had?" Huotari asked.

Koltin replied, "It's 50-50. Half of it is to go into fast-growth markets that they're not already in and get that best-in-class firm. The other half is to go build that firm of the future."

"Any kind of investment I see coming into the profession is a positive," said Peter Wen, co-founder and CEO of Tallyfor, a maker of taxflow automation technology. "I'm also curious of technology's role in the PE process. Do the PE firms look at the technology in place within a firm?"

Koltin said there hasn't been much discussion of technology yet. "Most of the top performing firms that have already gone to PE already had good investments in technology and innovation."

"How do firms that either aren't ready or choose not to go the PE route compete with firms that have all this extra cash and can hire people away and all those other things?" asked Scott Scharf of Acuity. "How do I protect what we have? And how do we look to the future so that we're evolving?"

Scharf was also curious to know what percentage of firms under $50 million are even considering PE?

Hood responded, noting that they've seen many of the larger firms getting the PE deals later acquiring the smaller firms. So, while PE firms may only be making deals with the larger firms, it may translate into M&A deals for the smaller ones.

"My concern from what I've heard, mostly of other professional services firms like medical, is that the PEs come in with all the money, but what is the impact on firm culture and how does it impact the firm's clients?" asked Diane Yetter, CPA. "The PE firms will have their own growth goals and operating procedures. What impact is that going to have?" Yetter is the founder and president of the Sales Tax Institute and YETTER Tax.

"And what has been the client response? I have yet to hear of a client with concerns – they just don't care. A press release goes out, '*We've now got a strategic capital partner*,' but it's almost like a firm went and got a bank loan. We do explain to clients why it will be good for them, allowing the firm to invest deeper and wider."

"I am seeing some panic from some firms because they have no bench strength," said Amy Vetter, CPA, founder of the B3 Method Institute. "So, with no partners coming up, they're trying to find a way out, through either a merger or a PE deal. Which is why many of us are trying to help firms restructure, whether to remain independent or to be attractive to PE firms."

Vetter added, "Speaking for many of us that have worked for tech companies, it's no easy route to work for a PE company. And you *are* working for a PE company. So, if you think you're getting cashed out, but you've always been a leader, a partner, the decision maker… that changes very quickly when a PE firm comes in."

"As Alan said, there's so much momentum now that this is happening, there's no turning back," said Sona Akmakjian, a CPA and Avalara executive. "But there are certain things in our profession we consider sacred: The value we deliver, the relationships we have with clients, our role as a trusted advisor. So how do we preserve those things? How do we educate the PE firms?"

Hood noted that former AICPA chair Barry Melancon raised this point a few years ago, regarding the importance of PE firms understanding the true value of the profession.

Koltin acknowledged that there are some PE firms that should be avoided, that are too focused on only the end numbers. But some are really good at understanding firm needs and letting them run their practices.

Dan Luthi, partner at Ignite Spot Accounting Services suggested that the large firm PE investments and acquisitions may cause a shift of personnel to existing and new smaller firms. "This is going to push people who are in large firms into smaller firms in the next two to three years, 100%. The organization's looking for a better return. And so they're going to have to offshore those resources to get it, which means they're cutting out stateside employees, which means local people with have good potential resources in that piece."

"I've learned something from each of you today, because I'm really concerned about how we advise firms to be wise in maneuvering through this," said Randy Johnston, president and founder of NMGI. "What I've learned is, there are some CPA firms who should stay the course with investment in their people, investment in their technology. And they've got to make sure team members are getting enough motivation in compensation opportunity and interesting work in the short term."

Long Term Consequences

Shayna Chapman, founder of ShaynaCo LLC in Gallipolis, Ohio, pondered the effect of these deals on the broader CPA firm environment: "I've worked in a larger firm, and now have my own small firm, and I'm thinking about this whole thing from all the perspectives. While PE could be just to benefit the partners, it could also be the change agent that accounting needs to push into other areas, because it does give us these tools. But how is this going to affect small firms? Doctors, lawyers and pharmacies are going to the mid-market, merging into bigger and bigger clinics and practices. And they were small firm clients, but now they're gone because bigger clinics use bigger firms. So, what will happen to these small firms? Will we lose them? And then what happens to the small clients that need service?

Hood responded, saying, "This will be something we'll have to see play out, because it will create lots of those issues. My suspicion is that we'll start seeing new firms pop up as some experienced staff start new firms because they don't want to be in a PE environment."

"What happens when the PE firms are done with an investment in 5-10 years? Well, I've seen a lot of acquisitions of tech companies that end up negative in the long term," noted Caleb Jenkins of RLJ Financial. "I'm not so concerned about the top 50 or 100 firms, but for the $5-$10 million firms that may get PE infusions, what happens to that firm when the PE firm is ready to sell?"

What is the Opportunity for Sub Top 100 Firms?

Koltin said there are three general levels of PE activity with accounting firms: The heavyweight PE firms going after the top-level firms; middleweights going after firms in the $100 to $400 million range, and the welter weights, who Koltin has seen going into firms as small as $10 million. Some family office groups are even investing in firms from $5-$20 million.

Is PE Right for All Firms?

"The harsh reality is that more than half of the CPA firms in the country won't qualify to be part of private equity," Koltin said. "Private equity is not for 90 percent of the profession. The reason is that the economic ‘deal’ essentially starts by “scraping” the partner group’s excess profitability (EBIDA) and then multiplying it by a benchmark number.”

“All of this being said,” Koltin added, “I don’t think all of the CPA firm private equity deals will be home runs but I wouldn’t bet against an elite, best-in-class CPA firm combining with a high performing private equity firm that specializes in professional services firms (the assets go home every night and decide if they want to come back the next day!), and can be a high level strategic and capital partner to the CPA firm.”

Also participating in the event were Geni Whitehouse, CPA, of The Impactful Advisor, Nayo Carter-Gray, EA MBA, of 1st Step Accounting, Donny Shimamoto, CPA, of IntrapriseTechKnowlogies LLC and Mark Koziel, CPA, of Allinial Global.

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