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Recession Report: What Should You Expect?

How is the recession affecting CPA firms so far? The answer, according to discussions with a number of CPA firm consultants, seems to be: it depends. Where your firm is located, the type of clients you serve, your firm's structure and strategic plan—all are factors that will affect whether your firm will be laying off or looking to acquire talent, reducing or freezing raises, and seeking to acquire firms and talent or being acquired.

While busy season has been a distraction of sorts from the recession—taxes and audits have to be done, no matter what is happening on Wall Street or in Washington—April 15 tends to bring economic issues back into sharp focus.

To get a broad range of views about what is likely to happen this spring and beyond, we asked leading consultants in early February to share their insights and predictions based on their interactions with clients. At press time, they agreed that:

- The situation is different depending upon where your firm is located, what kind of practice you operate, and various other individual factors. Because of this, there is no general picture of what is happening or what may happen.

- The size of your firm is also a contributor to how your firm may react to these issues. Local and regional firms may, in fact, be the winners in this recession because of “trickle down” work and available talent from the Big Four firms that have already been feeling the pain from the economy.

- Firms that are responsive and see these times as an opportunity rather than a curse are most likely to emerge as winners when the recovery comes.

The consultants (see the sidebar for the list of those we asked for input) had excellent advice and observations about how CPA firms are addressing the recession and related issues. These included increased client requests for fee relief and shopping for potential merger partners for later in the year. Some felt that things may become quite dire, while others were not yet seeing much impact as firms entered busy season and remained closely focused on busy season work.

An opportunity to “clean house.” Whether or not firms will be laying off staff in a few weeks depends, as noted above, on a lot of factors. In fact, some firms already have let staff go.

“About 20% of the firms I work with have already made significant layoffs,” said Allan Koltin,

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president/CEO of PDI Global Inc. "Another 40% or so clearly are looking at a post-busy season layoff, and the remaining 40%, for a variety of reasons, don't have any layoffs planned in the near future. In all instances, the reasons for the layoffs are economic in nature, due to the shortage of top-line revenue being generated."

Bill Reeb of the Succession Institute LLC agreed that layoffs have already begun for some firms, but believes that there may be more to it than "just" the economy. "Firms are using the economic downturn as a free pass to clean house of marginal people," he said. "For the most part, CPA firms do a marginal job of setting expectations and being consistent, and since I work with my firms on this, we have already done this weeding out to make room for new hires and people to be promoted." Some firms as of February were still in the "what if" stage, preparing for a worst-case scenario, he noted, and considering what they may choose to do after busy season.

Koltin said that when it comes to layoffs, it will indeed be the bottom 20 percent of performers who will be eliminated first. "The real question will be how deep firms will dig into the next 20 percent. Firms would like to hold on to these performers, as they'll have to rehire them once the economy ultimately turns around."

Layoffs may affect as many as 40 percent of firms, predicted Marc Rosenberg of The Rosenberg Associates Ltd. The recession is the main reason. "Most firms are saying they will be happy if 2009 fees equal 2008," he said. However, he agreed that this is a chance to evaluate staff and trim poorer performers, and could be a time when needed talent is added to the firm. "The number one factor will be to shed the weak performers," Rosenberg said. "After that, firms will be laying off their less experienced staff a lot more than experienced staff."

At the other end of the spectrum, Gale Crosley of Crosley + Company said, "the general tone is 'brace for impact' or 'waiting for the shoe to fall.'" As of early February, she said few firms that she works with are predicting or budgeting for layoffs.

Most of the consultants do not foresee the elimination of partners—yet. Even where firms are not removing partners, August Aquila of Aquila Global Advisors LLC predicted some changes in demands for partner accountability. In addition to more emphasis on accountability, he said some firms may add tiers of partners if they haven't done so already.

Koltin was the only consultant to report seeing partners being let go as early as this past winter. "Typically, the first group that has gone has been non-revenue/administrative support type partners (viewed as overhead). I am seeing this first-hand, as we've already had a handful of high level administrative type partners from Top 100 accounting firms using our search division to assist in helping them find a position."

Hiring and mergers: Is opportunity knocking? The flip side of "cleaning house" is that firms may be able to pick up staff and other practices or firms with more choices and more bargaining power in the current economy.

The economy may, in fact, give some firms the nudge they need. "Firms are absolutely planning on mergers," Rosenberg said. There's "no question that some firms who are on the fence about merging up will now go forward due to the uncertain economic times."

While interest in mergers will continue, Aquila observed that—if the recession lasts and revenues decline—there may be a small impact upon prices. He doesn't foresee a "fire sale" situation, however. "The bottom would have to fall out for that. A 5 to 10 percent decrease in revenue or profits is not enough to push the panic button." It is going to be more of a buyers' market in the near future, he noted, due to aging CPAs nearing retirement. So more firms will be available for purchase for that reason.

Steve Erickson of Steve Erickson LLC agreed that fire sales won't be a part of the picture this year. "Sophisticated strategic planning is focusing on niches and young partner group acquisitions," he said.

That strategy may be delayed until the completion of busy season for many firms, indicated Crosley. "There is a combination of wait and see, plus distractions with busy season. Strategic planning in many firms often involves looking only a few months ahead."

Expect to see both mergers and selective hiring this year, said Koltin. "I believe 2009 will be a record year for CPA firm mergers (similar to 2008)," he predicted, and furthermore, he believes that most will be straight mergers rather than cash deals.

While there may be staff to hire, Reeb cautioned firms to be careful about those hiring decisions. "Be very cautious about hiring experienced people to make sure they are a good fit," he said, adding that if you find good, experienced talent, now is the time to get those people on board.

How can you tell if you are acquiring talent that may not measure up? "I have been telling my firms to watch for CPAs that seem to change firms about every two years," Reeb said. "That is about the amount of time someone can get away with way-overselling their skills before they are finally weeded out. If someone moves into town, that is totally different. But be careful: There are a lot of five-to-10-year people out there that have one year of experience for five or 10 years in a row."

Compensation changes are still a question. Some firms will certainly reward their top performers as well as possible; others may reduce wages or freeze them across the board.

One interesting trend that may be encouraged by the recession could be a pay for performance approach, where firms dole out precious compensation dollars in larger amounts to the best performers and in lower amounts—or not at all—to staff who fall farther down on the performance continuum.

But the issue of how to handle raises for staff is a challenging one at the moment. "The profession is in a difficult situation. They've just thrown money at experienced staff and have passed this on to clients in fees," Erickson said. "Now clients are pushing back, so the rate of increases is decreasing.

Firms will honor their commitment to employees, but raises and bonuses could be limited or flat." He expects this to be handled on a case-by-case basis. And firms should keep in mind that the downturn presents new opportunities to staff who have never experienced a down economy.

Some firms were preparing to scale back on post-busy season raises by early February. "My firms have taken the approach that there will be limited to no raises until we see how the economy impacts the firm," Reeb said. "The message to our people has been that we are trying to keep everyone on board, and that message has been received fairly positively. We always try to consider non-financial rewards. Some firms have cut back, or committed to cutting back hours of a particular group in order to keep everyone, like cutting back to 32 hours a week for certain times of the year for administrative staff or certain skill levels."

A more varied response was reported by Koltin. "Some firms have already told staff not to expect raises and have certainly given that same message to their partner group. Others are talking about modest 2 percent to 4 percent raises. Believe it or not, there are still a percentage of firms out there that don't even know we're in an economic recession!" This is not the case in states such as Ohio or Michigan, which have been most affected by the recession.

Proactive firms already met with staff before busy season to explain the realities of the marketplace and what the firm was doing to control expenses. "I think a majority of associates in CPA firms today understand that they have received above-market raises probably for the last four or five years, and this year any raise would be welcomed, even if it is 2 percent to 3 percent," Koltin added.

Rosenberg agreed that raises will be smaller, indicating that about 75 percent of the firms he deals with plan on this, though the other 25 percent planned on normal raises as of February.

Partner compensation may be taking a hit as well, Erickson noted. Many firms with set pay and bonus pools may need to change those arrange-

ments. Erickson noted that partner compensation has been accelerating over the last five to six years—especially in the Top 100 firms—much faster and higher than employees' pay.

Bonuses this year may follow the pattern of compensation trends, although a "wait and see" attitude was the most prevalent during the winter months. This is especially true when it comes to partner bonuses, Koltin observed. "Most firms have frozen partner compensation and told partners it doesn't mean they won't get a big bonus at the end of the year; it just means that they're going to play it safe and wait to see what the results look like."

Action steps. Despite all the unknowns, the consultants had concrete suggestions in addition to predictions about how the rest of 2009 will go, including:

- **CPA firms need to adjust growth expectations.** Depending upon the practice, growth is becoming a changing factor in CPA firms, and both an attitude check and strategic adjustment are needed.

"Firms will be in pretty good shape coming out of tax season," Aquila predicted. "The second half of the year is the question. Clients could cut back on special projects, and that could have more impact. This is unknown."

The best strategy, Aquila suggested: "Firms need to get out of the office and get in front of clients. Help them to understand what they are doing. Quit the passive marketing!"

Firms need to adapt their plans to lower billables and revenues if necessary. "In the first 10 days of February, I had more firms reach out to me to tell me that their January 2009 billable hours were less than the year before and that, in many instances, this was the first time this had happened in the past 10 years," Koltin said. "The scary part for firms will be whether February, March, and April '09 results also lag significantly behind the prior year. If so, I think that post tax season, you'll see many, many more layoffs than we are anticipating at the moment."

Such impact may not be across the board, though. Koltin said: "As some firms are essentially what I would refer to as 'blocking and tackling' firms, they never really experienced a dramatic 'up tick' over the past five years, in terms of Sarbanes-Oxley or special project-type work. For these firms, while I don't want to say they are recession proof, they probably will continue to plow forward somewhat unaffected by the recession."

"The firms that are getting hit the hardest clearly are the firms that invested heavily in growth and now have found that the growth is not only coming to a screeching halt, but is suffering a significant decline. Firms that were heavily invested in financial services, private equity groups, hedge funds, home builders, auto dealers, and other related industries have taken a major step backward. Firms that had general type practices unaffected by those industries seem to be still doing well and, ironically, may find 2009 to be one of their best years ever."

Rosenberg was in the midst of surveying managing partners at the time he spoke with AOMAR for this story. From these conversations and the usual discussions with CPA firm leaders, he learned that about a third of the firm leaders were projecting 10 to 15 percent growth for 2009; about a third believed 3 to 5 percent growth was likely this year, and about a third predicted flat growth or lower fees than in 2008.

He shared some actions that firms are taking in response to the economy, including:

- Forming a client assessment committee to review client continuation based on ability to pay.

- Implementing strict collections policies including past-60 day accounts and monetary penalties for partners who don't bill WIP on a timely basis.

- Cutting "fluff" from expenses.

- Closely tracking metrics.

- Considering furloughs during quieter months.

—Spending more time with staff to keep them informed about how the economy is affecting the firm.

● **CPA firms now have an opportunity to redirect their strategies.** Whether your firm is one that was very growth-oriented and now needs to redirect or your firm has not focused upon growth up until now, it is time to reconsider this issue in light of the current market and opportunities.

“Firms are finally starting to get serious about growth,” noted Crosley. “They’re looking at all the things they haven’t done in recent years and are seriously evaluating how to rectify their ambivalence about driving growth. As a result, I see them considering or implementing hiring business developers, learning how to develop opportunities to increase the odds of winning clients, investing in sales training, and motivating partners to get more engaged in growth.”

Agreed Reeb, “We are trying to get our firms to see changes as opportunities. CPAs are needed in every economy. We give the message that changes like this can be seen as a time to hunker down and hold on, or leap-frog your competition. While we need to be cautious, it is time to aggressively

market our services, and even more important, rebrand our services to fit with the current outlook. We have plenty to offer our clients, and our focus needs to shift from compliance to assistance in getting through these troubled times.”

Reeb suggests a variety of ways to do this, including: rebrand internal auditing skills as “lean and mean assessment” services; emphasize fraud detection services; offer performance measurement services; and emphasize financing and cash management services.

Value is always in fashion, never more so than when clients are pinching pennies, noted Erickson. Offer to review fee structures, and actively demonstrate ways you can save money for the client through your work. This will impress clients and build goodwill.

In addition, be proactive in asking clients about critical business decisions they are facing this year. “We can help with this and it brings greater perceived value,” Erickson said. Your small business clients are likely to be suffering more in this economy because of limited credit availability; consider how you can help these clients, and offer ideas and options. □

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