



CPAs and Turnaround Professionals

The Indispensable Alliance to "Save" Distressed Clients

BY HOWARD BROD BROWNSTEIN

With the rapid changes taking place in the US economy, many corporate officers find their companies in tenuous financial situations. Unfortunately, we now see with ever increasing frequency companies that are struggling to deal with shrinking profits or growing losses. In addition to apparent economic pressures, the failure of some senior managers to meet these financial challenges head-on by reorienting their business models has and will continue to bring many companies to the verge of bankruptcy and others to financial collapse.

For faltering companies, experienced turnaround consultants can make all the difference between recovery and bankruptcy by helping to devise both short and long-term solutions to financial problems. As such, they perfectly complement the role of CPAs, who are also committed to helping preserve the financial integrity of their clients. Working together, they form a powerful alliance to help save distressed clients.

CPAs are acutely aware, especially in this recession, of the importance of doing everything ethically possible to help their besieged clients turn the corner to profitability. Failing to do so could jeopardize their own practices. Because CPAs may find themselves working with turnaround professionals, it's important to know what they do.

Turnaround Professionals

To begin with, turnaround professionals travel on a rigorous educational and ethical

track very similar to that of CPAs. In fact, some work in the restructuring departments of the Big Five, reflecting the growth and importance of this valuable consulting service that began in the 1970s.

The best turnaround firms are active in the Turnaround Management Association (TMA), a national organization with nearly 5,000 members including turnaround professionals, attorneys, lenders, appraisers, and other key members in the turnaround community, <www.turnaround.org>. Turnarounds & Workouts, a publication of The Beard Group <www.beardgroup.com>, recognizes the country's Top Twelve Turnaround Firms annually.

Among the most prominent TMA members are the 200-plus certified turnaround professionals (CTPs) who have demonstrated their career commitment to the turnaround profession by becoming certified by the Association of Certified Turnaround Professionals <www.actp.org>. Like CPAs, CTPs are required to meet demanding educational and professional standards. Specifically, they must have five or more years proven experience in turnaround management consulting, they must have undergone a rigorous background and reference check, and they must have passed a comprehensive exam covering management, finance, accounting, and law. They also are required to maintain their skills through continuing education requirements. Perhaps most important, CTPs subscribe to a code of ethics binding them to exercise

independence, candor and confidentiality, and many other requirements in all their client engagements.

The ethics and independence standards are important to keep in mind because turnaround professionals are often referred to clients by lenders, venture firms, attorneys, and key suppliers, which sometimes raises concerns about where their allegiances lie. However, the CTP designation reassures clients that conflicts of interest will be avoided.

Also, the turnaround professional is a specialist as is the CPA. However the turnaround professional focuses on the rapid analysis and treatment of business problems and, if possible, the early restoration of profitability. In many cases, turnaround professionals act as advisors to a management team that remains in place, typically reporting to the board of directors and working with a designated corporate officer contact, usually the CEO, COO, or CFO. However, in other cases turnaround professionals can act as interim or crisis managers such as chief restructuring officer.

Working with Turnaround Professionals

Sometimes, a CPA firm may be reluctant to assist in finding a turnaround firm, or resists cooperating with the turnaround professional, due to a misguided concern that the turnaround professional will criticize or replace the CPA. Of course, such fears are

completely unfounded. Turnaround professionals know that the client's CPA plays a critical role in the future of the client. Without the CPA's familiarity with the client, its special relationship built on trust, in-depth knowledge of the client's history and current circumstances, the turnaround professional would be hard pressed to undertake and complete successfully his or her assignment. That's why the best turnaround professionals establish contact with the client's CPA firm early and enlists its invaluable help and support. Here's how that relationship yields results.

When brought together, CPAs and turnaround professionals often work in a professional collegial relationship. In reality, they each bring a unique set of skills and expertise to the table. Relatively few turnaround professionals have a public accounting background, and all take care to clarify the difference between the services they provide and those offered by CPAs. On the other hand, unlike CPAs, who often interact only with senior management and sometimes with tax authorities and lenders, turnaround professionals must deal with a wider range of corporate constituencies whose support is critical to the company's survival. In some respects, they play an ambassador's role, building bridges, and developing consensus among disparate groups, some of whom may feel threatened by the outcome.

These groups include suppliers, customers, employees, shareholders, and even government regulators. Although the company's relationships with some or all of these groups may have become strained, the turnaround professional can frequently persuade everyone that the company has a reasonable chance to be once again the good borrower, customer, employer, supplier, and taxpayer it once was. The mere fact that the turnaround professional is an objective "outsider" with no personal axe to grind can help reassure all the constituencies and gain their support. However, sometimes the turnaround professional won't hesitate to wield the axe in weeding out individuals who are resistant to change. That could explain why they have earned the "John Wayne" image as the "US Marshall of the Wild West."

The turnaround professional's first task is to assemble a team made up of members from client's top management as well as from the turnaround firm. Because this team will be focused primarily on the financial integrity of the company, the CPA may be asked to undertake a number of analytical financial reports, work ups, compilations and projections that the turnaround process requires.

As soon as the turnaround team is assembled, the next step is to develop a "situation analysis" to confirm the company's financial viability. This is achieved through answering questions such as: What is the successful core business or businesses of the company? Which core businesses are or could be profitable? What organizational and financial resources are necessary to sustain the company and bring it back to profitability? Are financial resources available from internal or external sources?

The answers to these threshold questions, determined with the input of the CPA, will result in a strategic decision: Either the problem can likely be fixed or an exit strategy must be found. Most experienced turnaround professionals prefer to formulate a turnaround strategy that will enable the company to survive and continue its independent existence, and not be forced to seek refuge in a sale, bankruptcy reorganization, or liquidation. But turnaround professionals are not advocates or "rubber stamps." They will not recommend whatever plan management or ownership favors. Rather, they are objective like the CPA, and if an exit strategy is what is really needed, a turnaround professional will so advise the client.

A key tool used by turnaround professionals during the early stages of an engagement is a rolling cash flow projection that the CPA will doubtless be called on to help develop. This is a bottoms-up forecast of cash sources formulated on a weekly basis, depicting the next 13 weeks of operations, and is typically updated every four weeks. A "base case" projection is initially constructed that shows the trajectory that the company is currently tracking. The rolling cash flow projection becomes a "road map" by which course cor-

rections are made continuously as information unfolds. If the situation worsens, it can be recognized as early as possible.

During the turnaround process, CPAs may hear managers express fears about the turnaround professional, wrongly assuming that his or her only goal is to cut costs or reduce the work force. While it's true that a "zero-base budgeting" analysis of a business can result in the elimination of unprofitable or unnecessary activities, it is just as often necessary to increase the number of employees in order to effectuate a turnaround, such as when the sales efforts need strengthening. Armed with this insight, the CPA can help managers stay focused on the main objectives.

Once the business appears to be stabilizing, attention will be turned to business restructuring. This is when the more difficult questions must be asked, such as:

1. How did we get into this situation?
2. How can we prevent a recurrence?
3. What changes do we have to make in order to restore profitability and sustainability?
4. What resources do we need to implement these changes?

If these questions can be answered satisfactorily, then a turnaround should be achievable and the business can potentially return to more normal operations. In many cases, refinancing will be necessary, such as when a fresh start with a new lender would benefit the company. Here again, the CPA may be of help to the turnaround professional in the search for a lender who has had experience with the CPA and has confidence in his or her work.

Alternatively, an exit strategy may be needed. In fact, most turnaround professionals formulate an exit strategy every time just as a contingency plan. Exit strategies might include a sale or merger of all or part of the business, technology transfer, bankruptcy reorganization, or even a structured

liquidation. Even though some turnaround professionals are qualified to act as financial advisors in selling the company, e.g., to a strategic buyer when the time available is limited, in many cases it is preferable to engage an investment banker who is experienced at marketing distressed companies. If a sale is unlikely, a structured liquidation plan could permit the maximum realization on the company's assets by completing work-in-process in an orderly way, shutting down and selling off facilities systematically according to a plan, and maintaining the sale value of intellectual property, brand names, and customer lists—to name only a few.

Bankruptcy is a time-consuming and expensive process, and the statistics for successful reorganization of middle market companies are not promising. In the hands of an experienced turnaround professional and an experienced bankruptcy counsel, and with adequate planning, bankruptcy can be an effective sword rather than just a temporary shield. When a company's survival is in jeopardy, the CPA and the turnaround professional will most likely undertake an analysis to determine whether bankruptcy might be an appropriate tool.

There will be situations in which the CPA's client is either unaware of the severity of the company's trouble or is in denial that a problem even exists, a not too uncommon occurrence, especially among closely held businesses. Because the CPA is in a unique situation to see and understand the early warning signs, the CPA has an opportunity

to serve as a proactive professional and motivate the client to call in a turnaround professional at as early a point as possible. Needless to say, saving a client from disaster will go a long way toward reinforcing an already strong relationship while at the same time preserving the CPA's practice.

Signs That a Turnaround Professional Is Needed

What are the signs that may indicate the need to call in a turnaround professional? Here is a partial list of disturbing "blips" that should be posted on the radar screens of CPAs, keeping in mind that lenders are on the constant lookout for the same signals.

- Delayed or restated financial statements
- Operating losses
- Need for covenant waivers
- "Stretched" accounts payable
- Slippage in accounts receivable average DSO
- Increases in accounts receivable "dilution"—credits, returns, and adjustments
- Need to revise plans and projections, especially if this occurs more than once
- "Hockey stick" forecasts by sales department
- Erosion of order backlog/contract balance
- Excessive management turnover

- Glitches in computer system installations/conversions

Finally, timing is everything. A turnaround professional's chances for success go up dramatically when called into action before the lenders, creditors, or investors require management to call in a turnaround professional. If the company is running out of cash, the tools at the turnaround professional's disposal are far more limited. If the client is in denial that the company is on a perilous course, then a whole new set of challenges must be confronted by consultants and management.

The attentive CPA can add significant value to the client by knowing when to sound the alarm and urge that a turnaround professional be added to the company's advisors to help navigate the enterprise to a safe harbor.

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