The Current Climate of Mid-Level M&A and Top 3 Deal Breakers

By William R. Hagaman, Jr., CPA, Partner

The credit crunch and the current economy have no doubt put the mergers and acquisitions (M&A) market in a state of unrest. The good news is that there seems to be some life left in the privately-held companies sector generating revenues of $10 million to $100 million, with opportunities available to those who are willing to be patient and prepared.

Buyers are looking for bargains more so than they did two years ago. An ideal buy-out would include a company that has a good reputation within its industry and a solid customer list, but perhaps is not as profitable as it could be. Now may be a good time for these kinds of deals, as long as the purchasing company has the cash and clean books to take advantage of the opportunity in this tight credit market.

From start to finish, a M&A deal usually takes five to six months, beginning with the introduction of the buyer and seller to the signatures on the final contract. The bank financing will certainly have some influence over this time frame. Recently, a client who had no bank debt and clean books was able to fund a $15 million deal with low leverage in just three months.

Currently, some industries are seeing more M&A activity than others. In the New Jersey area, one hot sector is the security industry, which also includes manufacturers, distributors and service providers of electronic security equipment. In construction, despite the public perception that the industry is extremely slow right now, there are still smaller deals taking place. Some construction buyers are presently looking to increase market share, so when the real estate market turns around, they will be better positioned in the industry.

Pitfalls with M&A deals can indeed occur. Without question, a smooth and successful transaction requires proper outside advisement for both the buyer and the seller from the very
The Current Climate of Mid-Level M&A

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beginning of the process. By doing so, both parties can avoid or overcome the most common deal breakers including:

**Deal Breaker 1: Misrepresentation of the Facts**
Inadequate books and records can pose a real problem when a company is considering going up for sale. Typically, a letter of intent is based on initial financial information. However, due diligence may prove that the quality of earnings are not up to expectations. Thus, if the buyer wants to renegotiate price, the seller may not want to come down resulting in a deal breaker. If you are a business owner considering selling your company, it is wise to engage a reputable accounting and consulting firm into the fold at least two years in advance to help ensure all financial documentation is in order.

**Deal Breaker 2: Lack of Funding**
Lack of financial availability is the biggest reason why deals fall apart. In today’s market, traditional banks are far more selective with whom they are loaning money. There is not a lot of bank financing going on now. However, there are hedge funds with cash still looking to invest in companies that are potentially profitable or are in hot industries with growing potential (i.e. alternative energy).

**Deal Breaker 3: Bad Chemistry**
On occasion, buyers and sellers don’t hit it off personally. Ego can be a problematic issue, but it often gets resolved with a larger purchase price. It is rare that a deal does not go through at the eleventh hour because of issues of ego or bad chemistry.

A conflict of cultures within the two companies can also be a setback, with the seller being very concerned over key employees. In many instances, sellers have been careful about making good matches for their employees. There have also been cases where deals have included arrangements for key players to be bought out or given secured positions on the new management team.

**Conclusion**
There is legitimate concern that the M&A market will continue to be weak based on current economic indicators. It is also likely that bad headlines relative to fiscal institutions is not over, which may shake up the financial markets even further. But if you are an established company who is well-funded, you will be able to pick up deals in this and future climates. And if you are looking to sell, prepare your company now to be in the best position possible. The current M&A market is not completely dead...it still has a pulse.

For more information on mergers and acquisitions, please contact your local WS+B advisor.
New 403(b) Audit Requirement

How It Will Affect Your Organization

By Joseph S. Kline, CPA, Senior Manager

Last June, the Department of Labor introduced new regulations requiring organizations with more than 100 eligible participants to audit their 403(b) plans’ financial statements beginning on or after January 1, 2009. With the start of the initial audit year fast approaching, employers that contribute to a 403(b) arrangement must prepare for the complex challenges that lie ahead.

Established in 1958, the 403(b) is a tax deferred retirement plan available to public school employees and certain tax-exempt organizations, where the participant (as opposed to the employer) makes the contributions and investment decisions. Earnings grow tax-deferred until withdrawal, at which point they are taxed as ordinary income.

As a result of this change, 403(b) plans will be treated the same as any other pension plan for purposes of the annual reporting requirements. This new regulation, which is sure to be an arduous for everybody involved, will bring sponsors into an entirely new realm. While in some instances they had little involvement in the past, all sponsors will now be expected to have controls over the plan. Along with that, sponsors must also meet the extensive written plan requirement, a task some sponsors are still struggling to complete.

Further complicating the 403(b) is the allowance of a 90-24 transfer. These transfers give some participants the ability to assign their finances to a new investment custodian. As a result, many plan administrators may have lost track of certain assets because they may not have been notified of these transfers. Organizations must begin to get their information in order now, or they may encounter problems when they are audited in 2009. Some organizations, whose records are disorganized or even nonexistent, may need to work their way back to the inception of the plan in order to confirm that all of the assets have been identified.

While the 403(b) plans that did not permit 90-24 transfers and maintained good records can expect fees comparable to those of a well-administered 401(k) plan, others will face the financial pain resulting from incomplete records and decisions made many years ago.

It is important to consult with an accounting firm that has the experience dealing with retirement plans and working with clients affected by compliance with the Employee Retirement Income Security Act of 1974 (ERISA). Familiarity with the 401(k), which is similar to the 403(b) in many ways, will undoubtedly make this challenging undertaking a bit easier (as of 2008, the employee contribution, catch-up contribution and 415 annual contribution limits are all the same for the 403(b) and 401(k), and both plans allow Roth contributions, automatic enrollment, loans, rollovers and hardship withdrawals).

For more information about the planning and implementation of this new regulation, please contact your local WS+B advisor.
Is Your Self-Funded Health Plan Stable?
Questions You Must Ask

By Lewis D. Bivona, Jr., CPA, AFE, Principal

In February of this year, Attorney General Andrew Cuomo (NY) announced he was conducting an industry-wide investigation into a scheme by health insurers to defraud consumers by manipulating reimbursement rates. At the center of the scheme is Ingenix, Inc., the nation’s largest provider of health care billing information, which serves as a conduit for the alleged data to the country’s largest insurers.

Cuomo also announced that he has issued 16 subpoenas to the nation’s largest health insurance companies including Aetna, CIGNA and Empire BlueCross BlueShield. He intends to file suit against Ingenix; its parent, United-Health Group; and three additional subsidiaries. Cuomo’s investigation found that Ingenix operates a defective and manipulated database that most major health insurers use to set reimbursement rates for out-of-network medical expenses. Further, the investigation found that two subsidiaries of United dramatically under-reimbursed members for out-of-network medical expenses by using the erroneous data.

Why should other states worry if this is only happening in New York? The simple answer is other state attorney generals will likely pick up on this issue and champion it in their states; this issue could also potentially move to class action status. While fully insured health benefit plans have little to worry about retroactively (prospectively they could anticipate higher premiums), self-funded plans do since any finding will cause additional payments to be levied against the plan sponsor. While most in-area claims are covered by a contract that the third party administrator (TPA) has with an insurance company, most out-of-area and/or out-of-network claims are paid on a reasonable and customary (R&C) basis.

With Cuomo’s investigation and anticipated legal actions, greater emphasis is placed on determining a company’s exposure to undisclosed financial risks. Employers with self-funded plans have a fiduciary duty to assess their program’s compliance. From a SOX perspective, the employer cannot assume that their TPA is performing according to their wishes and complying with the myriad of laws and regulations without some oversight, whether direct or through an outside auditor. Most TPA agreements insulate the TPA from the liability of improper claims processing. However, if the TPA has underpaid claims for the employer, the employer will be held responsible. If claims have been underpaid for a number of years, the exposure could be material to the bottom line.

With health care comprising a major portion of a company’s budget, CEOs and CFOs cannot afford to overlook the potential impact on their financial statements. The above issues highlight the importance of monitoring compliance and performance of ERISA-based benefits. While ERISA plans offer employers various savings and freedom from multiple jurisdictional regulations, they do not relieve employers of the responsibility to exercise fiduciary duties. If you have not audited your plan within the last two years, you need to immediately. If you have audited your plan recently, did the report evaluate the impact of phantom discounts or R&C? Has it evaluated the fairness of benefit decisions and the veracity of clinical information supporting the decisions to pay or deny a claim? Is there consistency in your benefit decisions across the board? These are just a few questions that you must ask.

Look for this article in a future issue of Employee Benefit Plan Review magazine.

For more information on ensuring the stability of your self-funded health plan, please contact your local WS+B advisor.
Different Methods

For Valuing Your Business

By Edward Mendlowitz, CPA/ABV/FFS, Partner

Fair market value is widely used to describe the value of a business. However, there are other ways a business can be valued that may be more appropriate based on the circumstances.

Fair market value. This is used to value a business for tax reasons, particularly for gifts and estates. Its definition is found in a 1959 IRS revenue ruling and has been adopted as the standard for business valuations for many purposes. Consideration is also given to discounts from the proportionate value for non-control and minority interests. Limitations exist when a current value is needed in a divorce or dispute; when a business is actually being purchased or sold; or where there are special attributes that are not reflected in the earnings history such as a patent or new procedure that is just taking shape.

Following are other methods used to value a business:

Fair value. This is a legal concept employed in shareholder dissent and oppression matters to primarily protect minority owners from abusive and confiscatory actions by the majority owners.

Standards in a divorce. There are varying methods used in state courts for matrimonial issues that extend from what a business might be worth in an immediate sale to what it cost to create or to recreate to what it is worth to the present owner – concepts not used in the fair market value method.

Investment value. This refers to the value of the business considering the owner’s expectation of risk, return and potential. Included are synergies and special features aided by the owner, and not the distance of the “hypothetical” owner of the fair market value method.

Book value. This refers to the value reflected on the company’s books based on original cost with downward adjustments applied based on accounting and tax rules. Book value is rarely used when there are assets other than financial assets.

Liquidation value. This is used when it would result in a greater value than the other methods. However, there are differences in its application. The value of a business in a forced hurried liquidation would be substantially less than if it were exposed to the market with the liquidation occurring in an orderly fashion over a reasonable period of time.

Ego value. Many people invest in professional ball teams, restaurants and similar activities so they could be a “player” and not for the return on investment. These values usually have no bearing in comparison with the other methods.

Keep in mind that a valuation is the present value of future expected cash flow from that investment; that what is expected by one person is not necessarily what would be expected by another; and the method used should be chosen to yield the appropriate result given all the circumstances.

To learn more about the options involved in valuing your business, please contact your local WS+B litigation advisor.
WS+B Receives Two Practice Innovation Awards

WS+B has been named a 2008 “Practice Innovation Award Winner” by Practical Accountant magazine. WS+B received this distinction for two separate entries.

The first award honored WS+B’s Health Care Services Group, who developed an educational seminar program tailored specifically for not-for-profit hospitals, addressing the newly revised IRS Form 990, which had not been updated since 1979. The program has been assisting hospitals to ensure compliance with the new tax reporting obligations and – just as importantly – make sure the organization portrays itself in the most favorable manner to the IRS, state tax and charitable registration authorities and the general public.

The second award recognized WS+B’s innovative employee benefit option called the Shadow Stock Plan. Often called “phantom stock” or “performance based units,” the program is a unique way to strengthen employees’ relationships with the firm by allowing them a personal stake in the firm’s financial success. All firm employees, regardless of their functional role or job level, are eligible to participate in the plan.

Practical Accountant is a national magazine focusing on technical information for local and regional tax and accounting firms. The award, now in its ninth year, recognizes firms that take the lead in developing new or improved services and promotes efficiency in the practice of public accounting. Profiles of the winners of the Practice Innovation Award for 2008 appear in the September issue of the magazine.