Small Firm Solutions

Winning Strategies for Profitable Firms

Special Edition

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THE ECONOMY'S EFFECT ON SMALL FIRMS

From James Metzler, AICPA Vice-President, Small Firm Interests

How are CPAs across the country—and their clients—being affected by tough credit conditions and a troubled economy? That's a question that many practitioners may be asking themselves. To gain a perspective on current conditions, I recently called together the Small Firm Solutions *Editorial Advisory Board to discuss the current economic climate and how it is affecting their firms and their clients. Based on their observations and those of CPAs I've met throughout the nation in recent weeks, here's what practitioners are facing.*

Main Street businesses are seeing their credit tightened. Clients have had credit lines frozen or cancelled. In other cases, clients are offered credit but faced with tough covenant restrictions or requests for greater assurances about their creditworthiness. Assuming that borrowers' sales will shrink, banks are also demanding to know how businesses plan to cut back. Clients are more frequently being asked for financial forecasts, and significant forecast assumptions are receiving more scrutiny than ever. In some areas, community banks and credit unions have moved in to fill the gap left by retreating commercial banks.

Clients associated in any way with the home building industry are in trouble—or likely will be. This includes not only construction companies, but also plumbers, electricians and even title attorneys. In some cases, suppliers are willing to offer these businesses more generous financing terms to keep them alive, while other clients tap into personal wealth or liquidate assets to generate cash. Auto dealers are another hard-hit industry.

Individuals are also having a harder time getting credit. Some have seen existing home equity loans frozen. Even affluent clients with stable incomes are facing greater challenges getting mortgages.

Banks are under increasing pressure on multiple fronts. Their boards are urging them to increase loan quality, while the government is calling on lenders to free up credit.

Some businesses and individuals are borrowing on unused credit lines while they can. Some have rushed to take home equity or other loans now on the assumption that banks will cut off or tighten credit further in the future.

Some CPA firms are expecting their first revenue declines in years. Many practitioners are focusing on practice development after many years of strong demand for their services. Others are canceling or scaling back hiring plans. More clients may try to tackle their own returns during this busy season, but CPAs predict that experience will only make them appreciate the value of a professional's services next year.

At the same time, clients need their CPAs more than ever. While some practitioners report fee pressure, others say they have seen little resistance because clients acknowledge the value of their services.

Long-time clients in financial trouble leave CPAs in a quandary. Practitioners are balancing their firms' best interests against the needs of good clients who have fallen behind in payments. When dealing with new clients, some firms require advance payments or retainers or institute pay-as-you-go plans. For struggling long-time clients, approaches include sending smaller but more frequent bills; asking to be paid with a credit card; or requesting promissory notes.

Older clients may be better equipped to handle the downturn. Those who have weathered previous recessions are often calmer and can draw on past experience to solve their problems. Those under 40 may have more difficulties adapting because they have never been through a real downturn.

The situation is not universal. Regions that did not experience a boom during the last decade may not suffer the same level of setbacks as those that did. Elsewhere industries, including those associated with health care, are doing well.

Communication helps immensely. In a time of great uncertainty, practitioners advocate reaching out to clients for whatever reason, such as asking about their business or simply catching up on their family. This can provide an opportunity to open up an honest dialogue on how to solve their problems.

On that note, this special edition also contains a client letter created by the AICPA Private Companies Practice Section with ideas on overcoming cash and credit challenges. I urge practitioners to send it as a special mailing or use it as a list of talking points to open up communication during these tough times.

James C. Metzler

CLIENT CREDIT CRISIS COMMUNICATION

During troubled times, clients turn to their CPAs for insights into how to avoid missteps and protect their businesses and investments. To help all of our members respond to their concerns, the AICPA Private Companies Practice Section (PCPS) has created this letter that practitioners can send or email to clients with advice on surviving the credit crisis. We encourage you to circulate it to clients to remind them that you are there to help them address the many challenges facing their businesses.

Dear Valued Client:

The recent credit crisis is just a reminder of the importance and benefits of having a sound strategy that you can use to navigate through turbulent times. Don't hesitate to contact your CPA for objective guidance in helping you make intelligent financial decisions for the future of your business. In the meantime, below are some tips to help you assess your current financial condition and start rethinking your business plan to face the current economic challenges.

1. Don't panic. It's difficult to make sound decisions if you do. To get a better sense of where you stand, begin by reviewing your cash position and anticipated cash needs. Are they in line with your business's short-term needs, goals and risk tolerance?

2. Take a fresh look at your monthly income and expenses. Have you been meeting your budgeted projections? How much of a drop in revenues can your business withstand and for how long? What are your cash-flow needs for the next 90 to 120 days? Or 120 to 180 days? Do you have sufficient cash reserves for the next 30 to 60 days?

3. Check with your lenders on the status of your credit lines. Are you in compliance with their terms? Will your bank renew their commitments at similar amounts, rates and terms?

4. Eliminate your reliance on credit by disciplining your spending.

5. Refocus on your balance sheet and how much credit you are extending to your customers.

6. If your credit lines are frozen or at their maximum limits, consider meeting with vendors and working out a schedule of partial payments that would allow continued delivery of critical materials and supplies.

7. Look into alternative types of financing. Some to be considered are loans on life insurance policies, loans from key customers that rely on your business for their materials and supplies or from labor unions, local development agencies or the U.S. Small Business Administration.

8. Keep an eye on your accounts receivable. Watch for new patterns of slow payments and follow up immediately. Review your largest and riskiest accounts to determine whether credit constraint or economic slowdown will affect their ability to pay you. Keep receivables aging current at all times.

9. Manage accounts payable more closely. Forfeiting early pay discounts may be more advantageous in preserving cash that may be needed for critical items. Keep payables aging current at all times because that's an important tool for managing cash.

10. Analyze your expenses and determine which ones can be controlled. Can you reduce spending in any areas to put less of a burden on your cash-flow needs? As necessary, communicate to staff/team members about the need to tighten spending. If you are a manufacturer, review inventory management practices. Are there opportunities to reduce your on-hand inventory? Service companies should make sure they're capturing all their billable hours and invoicing promptly. Have you billed all your

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contractual items? How about all your pass-through expenses, such as billable third-party services and travel and living expenses?

11. Consider ways to pass your increased costs (i.e., fuel expense) on to your customers.

12. Check the safety of any cash deposits you have. On October 3, 2008 the FDIC deposit insurance was temporarily raised from $100,000 to $250,000 per depositor through December 31, 2009. If you have more than $250,000 in any one bank, move the excess to another FDIC insured bank. Consider investments such as CDARs (Certificates of Deposit Account Registry) to spread the risk of short- to medium-term cash you may have invested in CDs.

13. Don't engage in panic selling of your investments. Make sure your portfolio is diversified and in accordance with your risk tolerance.

14. Come up with a plan NOW to respond to future declines in revenues, before they actually occur. Re-think your business strategies and update projections. Review your product/service lines to identify the most profitable items and determine how to leverage for future growth in profits.

15. Contact your good customers. Even casual discussions can lead to new business opportunities.

16. Review all your insurance coverage, particularly any from companies with weak balance sheets. Be careful not to surrender a policy, as securing new coverage might require underwriting that can affect your coverage.

17. Calm your employees' fears about how this crisis will affect the company, their jobs and their retirement or other benefit plans. Speculation and gossip are counterproductive, so it's better to address their concerns directly.

For help in understanding some of the issues facing small business, you can turn to the CPA profession's free Financial Literacy Web site for consumers, http://www.360financialliteracy.org. It offers tools and tips to help you make important decisions for your business and your own personal financial planning needs.

Finally, remain focused on your own advantages. Remember that:

- Small businesses have greater flexibility and can more easily adjust to changes in the economy than their larger counterparts.
- Small business owners can use the recent crisis as an opportunity to buckle down, refocus, assess and make their company more financially sound, disciplined and less reliant on credit.

During tough times, it's important to maintain communication with your CPA firm, your trusted adviser. Remember that you are not alone. We know and understand your business and the challenges you face, and we can work with you to navigate these turbulent times. We can help you gauge your current situation in the wake of recent market events and create a sound business plan in response. Contact us today for expert advice on how to maintain your company's success. ■

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SMALL FIRM SOLUTIONS *is a quarterly e-newsletter designed to help AICPA members in the smallest firms make the most of their opportunities and keep track of important developments in the profession. It offers news updates as well as articles with practical solutions to common practice challenges.*

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