

## **UPPER CRUST CLIENT FINANCIAL RESTRUCTURING : THE NEED TO EDUCATE CLIENTS AND LAWYERS ABOUT THE ESSENTIAL ROLE OF THE CPA**

Howard C. Meyers

There is a large and lucrative market for financial restructuring services required by many of Arizona's upper crust high profile CPA clients who have been struck with some form of financial malady as a result of the changes in the state and national financial climate since 2007. In order to capture their fair share of this market, CPAs practicing in Arizona need to engage in an education effort directed both at their clients and to the state's legal community.

This education effort is not just a matter of marketing and accounting practice economics. Rather, it also involves issues critical to client protection and welfare. Financial restructuring for and on behalf of upper crust high profile clients conducted without the participation and involvement of their CPAs is often doomed to generate a host of ongoing income tax and financial problems for the such clients. There can be a disastrous impact on the quality of their personal and economic lives in such cases which creates an unbelievable amount of misery and anguish.

Through proper education efforts, clients and lawyers can become aware of the need to include CPAs as an indispensable part of the financial restructuring and workout process. Clients will benefit from the input of experienced CPAs which will protect and mitigate against untoward and unnecessary adverse income tax and financial consequences which otherwise might arise. Lawyers will benefit because they will have assurance of the necessary income tax and financial input required because of the

complex multilateral nature of the financial restructuring and workout process which requires that the client have the benefit of a sophisticated decision making matrix whose development and implementation is often beyond the capabilities of a lawyer who is unaided by the client's CPA. In addition to assuring a better outcome for the client, the involvement of the client's CPA greatly reduces the prospect of the lawyer having any professional liability issues from unintended income tax and financial consequences which were not properly developed and disclosed to the client during the financial restructuring and workout process.

While the individual situations of upper crust high profile clients will have unique elements and variables, Arizona CPAs will find that the majority of such clients will fall within some discernible patterns. Sometimes there is total financial ruin on the horizon for such clients which implicates a chapter 7 liquidating bankruptcy but more often than not their financial situation is best encapsulated by the title of the classic spaghetti western "The Good, the Bad and the Ugly." Clients in the latter category are often ideal candidates for financial restructuring if the diseased branches of their financial tree can be cut off without killing the healthy portions of their financial tree. Such clients oftentimes have significant core businesses or employment and they sought to leverage their cash flow and financial statements into a more diverse pool of equity investments that were intended to move them up the financial ladder. The weight of these failed or troubled equity investments is now sapping such client's cash flow from their core businesses or employment. Such clients have too much to lose if they do not wake up and take proactive steps to financial rehabilitate themselves to preserve as much of their net worth and income producing capabilities as possible.

By way of illustration, there are the physicians with still large incomes who guaranteed construction loans for the development of now foreclosed speculative houses in the luxury venues of Phoenix and Tucson; the corporate executives of successful publicly traded companies and privately held companies who used once valuable stock as collateral for bank loans used to finance outside investments with both the stock and the investments now being worthless; and the highly leveraged large scale dairy farmers whose equity has been decimated by multiple years of operating losses caused by production costs in excess of the market price for milk and a radical drop in the value of the dairy real property and their herds. Simply put, these types of clients have a great many pressing issues (litigation, cash flow, inability to renew or refinance credit facilities, poor sale prospects, etc.) as a result of their declining financial circumstances.

Some clients of CPAs directly negotiate with their major creditors, usually banks, without the benefit of any professional assistance from either a lawyer or a CPA. These clients usually engage in some form of simple balance sheet negotiation based upon their net worth or a form of equity analysis (fair market value minus liens) in a particular asset serving as collateral for a lender. The “meltdown solution” is often imposed by the creditors which tends to involve a distress sale, deed in lieu or an improvident withdrawal from an IRA or similar retirement vehicle. Such clients tend to feel relieved and self congratulatory about their success until after year end when the process of providing information to the CPA for the annual income tax returns begins and the client begins to discover belatedly the sobering details of the true tax cost of the client’s self administered workout. Clients with these propensities have to be alerted about the need to obtain the involvement of their CPAs to arm them with the necessary financial road

map (including information about tax consequences and tax costs) for their financial restructuring and workout before they begin negotiating in earnest with their creditors.

Financial restructuring has also become a booming business for Arizona lawyers. While some lawyers have had a long term commitment and specialization in financial restructuring in and out of bankruptcy (i.e. bankruptcy specialists certified by the State Bar of Arizona Board of Specialization, business bankruptcy specialists certified by the American Board of Certification, creditors rights specialists certified by the American Board of Certification, etc.), many nonspecialist lawyers have responded to bad times in their former areas of practice and climbed on the financial restructuring band wagon, whether truly qualified or not. Unfortunately, not all of these newly minted financial restructuring lawyers know that the client's CPA should become an essential member of the workout team with regard to any financial workout or restructure. They do not understand that the CPA should jointly participate with the lawyer on financial and tax issues and their input sought because of the CPAs generally superior knowledge and expertise in these areas. One failing of these lawyers who have newly migrated into this practice area is that they often pay scant attention to the true tax cost of certain of their settlements or case outcomes. Disturbingly, these lawyers sometimes fail to factor in the necessary payment of applicable income taxes by the client which can leave the client in serious debt to the IRS and the ADOR without the means to satisfy these tax liabilities.

Despite adversity, many of these higher profile clients have both the remaining financial liquidity and the need to make substantial financial commitments to the lawyers they are hiring. However, both these clients and some of the lesser experienced lawyers they retain often fail to properly appreciate the need to make similarly substantial

financial commitments to their long standing CPAs to help such clients to overcome their current problems and get back on the road to financial recovery. From a cost-benefit analysis, the expense of obtaining the input and participation of the client's CPA in the financial restructuring and workout process provides a very positive and measurable economic return for the client. Clients need to understand that this functionally converts the cost of their CPAs' services from an expense into an investment.

Because of an educational vacuum, many clients and lawyers have little appreciation about how valuable a resource the client's CPA can be. After the higher profile client first realizes that they are beset with financial difficulties and engages new legal counsel to assist the client in working through their situation by way of defending litigation, negotiating settlements with lenders and other key creditors and, if necessary, filing for chapter 11 reorganization under the Bankruptcy Code., the client's CPA should be regarded as being at least as important and essential as the lawyer in the process in the financial restructuring and workout process.

In order for the newly engaged lawyer to give strategic and meaningful advice to the client, the lawyer needs meaningful and up to date information of the following general nature: using operating losses or income averaging to create refunds, historic summaries of income and expenses, *pro formas* rooted in realistic assumptions reflecting a range of operational results from the best case to the worst case and tax projections reflecting the potential result of either asset sales, stock sales, foreclosures, deeds in lieu of foreclosure and income from cancellation of indebtedness. This range of informational needs includes certain nonattest services of a consulting or advisory nature which vary from case to case and which can often best be modeled by the CPA

for the benefit of both the client and the lawyer.

The quickest and most accurate source for the information and work product required on a “fast track” basis is always the client’s CPA. While many times the assistance of the client or the client’s in house staff is required as to the most recent information reflecting activity beyond the cut off date of the last major work product prepared by the CPA, the objectivity and depth of knowledge of the CPA makes the CPA’s input usually much more reliable and balanced than that which is sometimes received from the client or the client’s in house staff. The client’s inability to accept responsibility for strategic mistakes (often failing to anticipate or to react quickly enough to changing market conditions) or fear of change sometimes clouds how and what they relate to the attorney. The client’s in house staff members often appear inhibited from speaking frankly, whether due to concerns about job retention or concerns about concealing weaknesses in their core competency. In addition to the objectivity which is inherent in the independence standards contained in the Code of Professional Conduct, CPA’s often spot and filter out for the lawyer various financial errors and distortions which are routinely overlooked and not understood by either the client or the client’s often lesser trained in house staff.

Because of the educational vacuum, clients and their lawyers often have little appreciation about the broadness of the range of services and expertise available from the client’s CPAs. If one puts a gun to the client’s head and asks what their CPA can do for them, the range of answers from the typical client starts petering out after tax planning, tax returns, audit and attestation services and a few other usual and customary lines of work. The same is often true of lawyers, particularly those who have

responded to bad times such as these by newly identifying themselves as specializing in work outs and financial rehabilitation despite any lack of meaningful experience or credentials in the field.

The higher profile client beset with financial difficulties often needs financial analysis in order to assist the client and his lawyer in formulating a viable and realistic financial plan. This includes what-if scenarios and other types of materials beyond standard financial statements as described above. If the subject of meeting this need is brought up with the client by the lawyer, the lawyer has to know that the client's CPA is usually the most logical person to fulfill this need and communicate this to the client. On their own, most clients are not familiar with the full range of services their CPAs can provide when the need arises.

Particularly for a newly engaged lawyer, the desirability of bringing the client's preexisting CPA into the mix is to assure that the client continues to receive trusted and independent advice from somebody who has a deep knowledge about the client, the client's financial and tax affairs and the skill set necessary to partner with the lawyer in helping the client to resolve their situation so that they can start moving forward again. The CPA's involvement represents a check and balance against the unfettered control of the newly engaged lawyer over the client's situation. This should be looked at as being in the best interests of the client as well as in the best interests of the newly engaged attorney.

The client's CPA needs to be in a position of professional partnership with the attorney from the very beginning of the attorney's engagement until its conclusion in order to assure the client of the best possible result both legally and financially. There is

a financial and tax dynamic that has to be properly matched with the legal dynamic. Every aspect of the legal plan and its implementation has a reciprocal financial and tax aspect. The CPA's involvement at the earliest stages of the lawyer's initial involvement assures that the client as the ultimate decision maker is getting both the essential legal input and the essential financial and tax input necessary in order to make fully informed decisions which are crucial to the client's financial present and future.

In conclusion, the CPA must educate clients and the legal community to realize that the in depth involvement of the experienced CPA in the financial restructuring and workout process is invaluable. Such in depth involvement harnesses the CPA's financial and tax expertise with the legal expertise of the lawyer for the benefit of the client. Neither the lawyer nor the CPA alone can meet the specialized needs of the higher profile client beset with financial difficulties. But aligned together in professional partnership, the lawyer and the CPA jointly become a powerful force to assist the client avert disaster and to move the client forward towards a meaningful and positive resolution of their predicament.