
Private Equity and Accounting Firms

By Kerry Pechter Thu, May 19, 2022

"I'd like to call this the 'private equity invasion.' With rock and roll, it was the British invasion. You know, the Beatles and the Rolling Stones. This is going to be huge." Uh-oh.



My threshold for surprise is fairly high.

Many years ago, the telephone rang at my desk in the smoky *Billings Gazette* newsroom. A drug dealer offered crocodile condolences: A man with whom I'd had lunch in a cafe in Red Lodge the previous day was dead. The dead man had been a witness in the dealer's criminal trial.

That set my benchmark for surprise.

This week, I spotted a [headline](#) on the *Accounting Today* website. It said, "Private Equity in Accounting." The accompanying podcast transcript also contained the word "annuity." The needle on my internal surprise-meter didn't red-line, but it quivered.

For his podcast, the magazine's editor had interviewed a business broker about the excess of "dry powder" the private equity firms had received from clients, and how the PE firms were inclined to use it to buy accounting firms for the accountants' "recurring revenue"—their "annuity of tax and audit" services.

"One of the more interesting developments in the past couple years has been the entry of private equity into the accounting space, with PE firms taking stakes and creating ventures with major accounting firms," the broker told the editor.

"I'd like to call this the 'private equity invasion.' So with rock and roll, it was the British invasion. You know, the Beatles and the Rolling Stones. This is going to be huge," the broker said.

Given years of low yields on publicly-traded debt and a scarcity of bargains in public equities, institutional investors have, in their search for higher yield, pressed hundreds of billions of dollars on asset management firms for astute investment in custom-made,

relatively illiquid private equity and credit instruments.

As *RIJ* has reported in our series on the “Bermuda Triangle” phenomenon, some private equity firms have applied some of that dry powder to the purchase of life/annuity companies or blocks of annuity business. This gives them new money—annuity premiums—to manage and to invest in the private credit instruments they create. Retail annuity contract owners—mom and pop—are less sophisticated and demanding than institutional investors but just as yield-hungry.

The idea that the larger and larger private equity firms would own larger and larger accounting firms was introduced in the *Accounting Today* article.

“The big question everyone has is, ‘Who is private equity gonna sell to when they have that liquidity event?’ And it’s our belief that it will either be another private equity firm that’s doing the same thing, and big will become bigger, or rather gigantic,” the broker said, or “it may be another CPA firm, or it may be another party that’s totally uninvolved in the business of public accounting.”

When impatient, yield-starved investors throw money at asset managers, the performance incentives can become huge. The process can be hard to stop. It’s like the well-known folk tale of *Rumpelstiltskin*, in which the miller’s daughter, unable to spin straw into gold though her life depends on it, comes to rely on a troll who knows how.

That tale ends more happily than the story about Allianz Global Investors US, which broke this week when the Securities & Exchange Commission accused the asset manager and three of its advisers—who admitted to the charges—with taking a lot of straw from institutional investors and lying to them before and after the COVID-related market crash of 2020 ruined its flawed formula for turning the straw into gold.

The incentives were huge, and ultimately turned perverse. AGI US paid the advisers—whose individual base salaries were no more than \$300,000—some \$101 million in bonuses from 2016 to 2020, according to the SEC. The business was so lucrative for AGI US and the advisers that, when it melted down—as a result of un-fiduciary risk management and a black swan event—the incentive to hide the truth was evidently overwhelming.

So what happened back at the cafe in small-town Montana all those years ago?

Two middle-aged West Coast outlaws, their two young street-dealing accomplices and a femme fatale were lying low and dealing pot and meth out of a house at the foot of the

snowy Beartooth Mountains. They believed that contributions to local law officers would allow them to distribute their products in peace.

As out-of-towners from the big city, the five never foresaw that rural gossips would instantly notice them. Soon there were FBI stake-outs, a messy raid and, before long, an indictment by the county attorney and a stunt-filled trial in a Victorian-era courthouse with portraits of bearded old jurists on the walls.

One witness, a deputy sheriff aware of both the crimes and the corruption, fatally sat down to lunch one day with the reporter covering the trial. Since Red Lodge boasted only one good cafe, their table and their Monte Cristo sandwiches were in full view of all the other principals in the case.

The next day, I received that surprise phone call.

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