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After the Acquisition: Here are Seven Steps to Successfully Integrating Finance and Accounting Functions After a Merger or Acquisition

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Cover Story

After the Acquisition

HERE ARE SEVEN STEPS TO SUCCESSFULLY INTEGRATING FINANCE AND ACCOUNTING FUNCTIONS AFTER A MERGER OR ACQUISITION.

By Barbara Tarasovich, CPA; Bridget Lyons; and John Gerlach

While merger-and-acquisition activity has slowed dramatically over the past 18 months, strategic acquisitions continue, and many companies are now faced with the challenge of integrating businesses acquired earlier. After the acquisition decision headlines fade, the integration of a new business entails completing a complex array of activities in a short period of time. Here we outline key issues and detail steps critical to success that provide guidance for financial controllers, directors, or managers responsible for the planning and implementation of a business integration.

Although much has been written regarding the factors critical to successful integration after a merger or acquisition, very little research has focused on the particulars of integrating the finance and accounting functions of the companies involved. As with overall business integration, detailed planning, effective communication, and speed of execution are critical. In addition, the finance function is challenged with such issues as the identification and safeguarding of the assets of the business, compliance with the Sarbanes-Oxley Act (SOX), review of information technology systems, conversion of accounting systems and procedures, and the measurement of synergies post-integration.

We recommend a seven-step process that will help balance the needs of the business during an acquisition as well as ensure financial controls are established. The overall steps provide the key activities to be accomplished and provide specific and explicit guidance.

The steps are listed below, are then described, and are followed by questions management should consider regarding the integration.

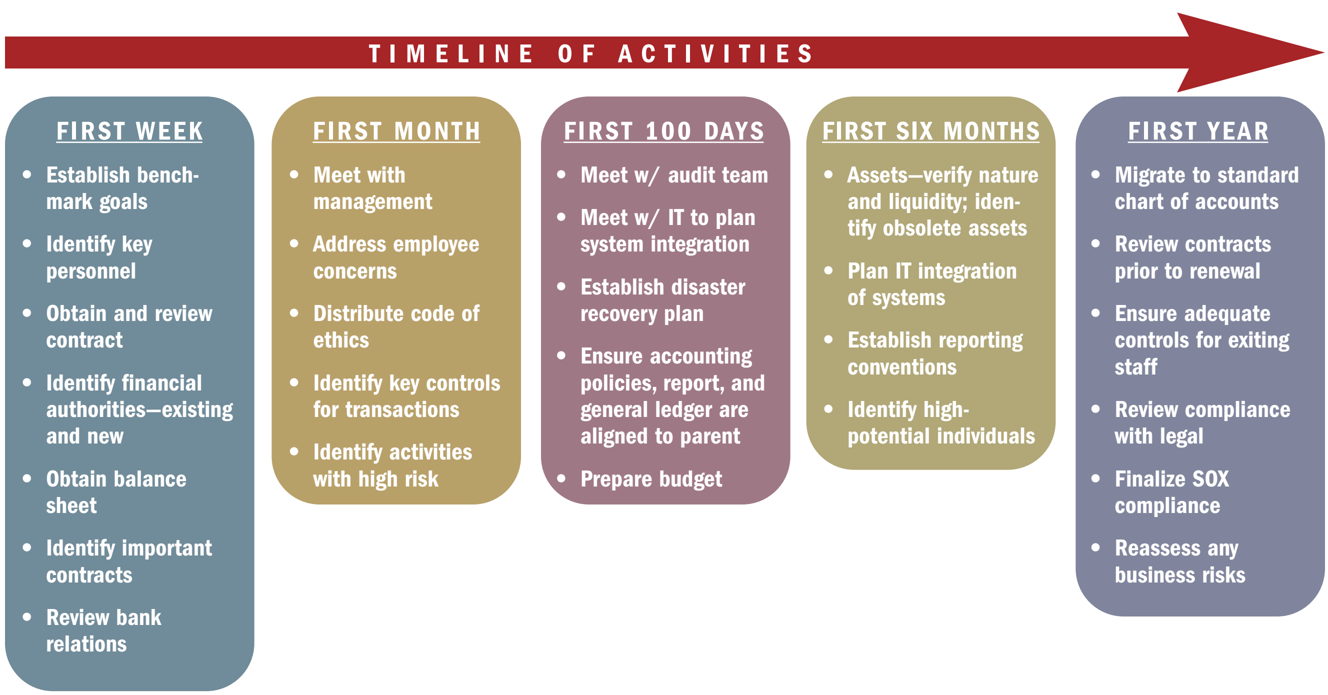
1. Begin planning, creation of timeline, and benchmarking.
2. Evaluate personnel in finance and accounting functions.
3. Safeguard the assets of the business.
4. Ensure adequacy of financial controls.
5. Review information technology systems.
6. Integrate financial and management accounting.
7. Assess progress, and perform post-integration analysis.

1. Begin Planning, Creation of Timeline, and Benchmarking

Often an integration has been well planned—even before the deal is announced or finalized—to ensure that integration is feasible and can be executed swiftly. The finance function is involved in the preplanning phase in the roles of due diligence and of ensuring steps are in place to permit a swift integration after the deal. Ideally, the finance and accounting staff working on due diligence provide important information to those directly involved in the integration process. They should also forward any questions or concerns about the integration to the rest of the due-diligence team since such concerns may impact the valuation and viability of the deal.

We recommend that the finance function develop a timeline for the broad activities that need to be addressed in this pre-integration period. This timeline indicates when the activities should be accomplished and can be implemented from the first day the decision to integrate is made. See Figure 1 for a sample. It's also important to include the plan goals so you can benchmark against them and assess progress toward these goals at regular

Figure 1: Planning, Timeline, Benchmarking



THE BIG PICTURE

The seven steps we are discussing here are a subset to the overall planning that takes place starting with the announcement of an acquisition through the closing and the first year of combined operations. Shortly after the announcement of an acquisition, one *Fortune* 500 company established a Due Diligence Team composed of middle-level managers from each of the functional areas of the business and led by an officer experienced in evaluating and integrating acquired companies. At its first meeting, the team would:

a. Agree on the assignment of responsibilities of team members for the due-diligence process. (Most of the team members would also continue to have responsibilities for the integration of the acquisition after the closing.)

b. Establish a timeline and benchmarks for the due-diligence process.

c. Prepare a list of the documents and data from the acquisition target required by each team member to carry out his/her responsibilities, e.g., detailed financial schedules, contracts, résumés of the key managers, etc.

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intervals. During the first phase of the implementation, it's also crucial to determine who is accountable and responsible for each of the financial processes to be integrated. This can vary depending on the organization structure of the two companies. As an example, the responsibility for physical asset validation may be either within the finance function (e.g., controller's department) or within operations (e.g., Supply Chain function). The acquired or integrated business must be aligned with the organization structure of the surviving entity. This is accomplished by preparing a detailed list of the key activities performed in each major functional area and comparing the list to the surviving company's organization structure.

Questions for management to consider:

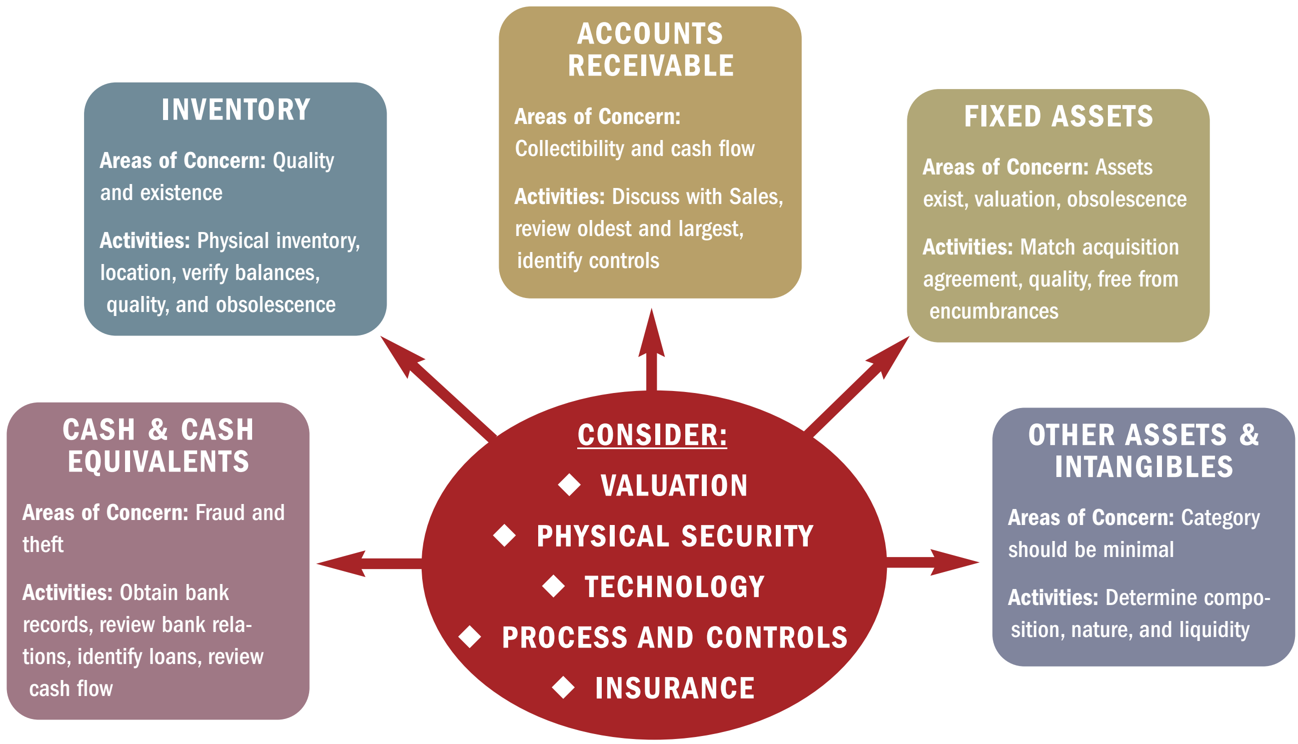
- Have we developed feasible and appropriate timelines and communication plans?
- What are the business and cultural impediments to integration?
- What degree of integration is required to meet forecast synergies?
- Who is responsible and accountable for each finance process to be integrated?
- Who needs to be consulted or informed about each process within the scope of the integration?

2. Evaluate Personnel in Finance and Accounting Functions

Acquiring firms should immediately assess the capabilities of accounting/finance personnel at the target firm to determine who stays, who moves, and who goes. Naturally, employees are concerned about what role, if any, they will play after the acquisition. "What happens to me?" is top on their list of questions. If this isn't answered, productivity usually suffers. This is especially challenging when integrating the finance function because an acquisition frequently results in duplication of roles, which creates fear and uncertainty because it's quite likely some staff will be made redundant. Even for key personnel who aren't concerned about losing their position, uncertainty regarding their career path arises. It's critical to identify these key personnel during the due-diligence process and to communicate with them immediately if you want to keep them. Reassure them of their value and future career track.

We recommend appointing integration team members from both the acquired and acquiring company. Then ensure there's a shared vision, and communicate any

Figure 2: Safeguard the Assets of the Business



location issues as soon as practical. Be aware of cultural differences, and work to build trust. Set SMART goals—goals that are specific, measurable, acceptable, realistic, and timed.

Also appoint a full-time integration manager.

In addition, it's a good idea to assess which employees have high potential and which ones might be underperforming. (You may want to partner with Human Resources on this one.) You also will need to assess what kind of training the finance and accounting staff will need in order to make the integration a success.

Questions for management to consider:

- Which personnel at the acquired firm have the capabilities needed in the integrated firm?
- Are the human resource issues communicated clearly?
- What are the key differences in the cultures of the two firms?
- How can these two cultures be merged? Would the process of merging cultures be facilitated by using an outside consultant?
- Have you identified and communicated with key employees you want to retain?
- Are you regularly communicating updates on the integration?

Town hall meetings are an effective way to communicate with staff and build trust. Management should be prepared to meet with employees as soon as possible—and ideally one-on-one—to detail new roles and responsibilities.

3. Safeguard the Assets of the Business

Integration of the business requires those involved with the finance function to identify and safeguard the existing and acquired assets. This involves identifying the assets as well as any potential issues or concerns. Figure 2 illustrates how assets can be identified and how issues of potential concern can be highlighted.

If there are excessive assets, including inventory and cash, management can work to reduce investment in working capital and thereby improve profit margins. As an example, damaged or obsolete inventory should be identified and a decision made whether the inventory can be returned to the supplier for refund or whether it should be disposed of. A stock aging listing by SKU (stock keeping unit) will facilitate this process.

It's also important to identify leased assets, inventory likely to be written off, and any stock on consignment.

For example, during one acquisition lack of awareness of leased assets resulted in a cash flow problem for one finance manager. Not realizing the assets were leased, they hadn't considered the lease payments in the cash flow projections and, as a result, didn't have the cash to make the payment.

Intangible assets are often ignored during an integration, perhaps because of their lack of visibility, but you need to identify and manage them. For example, a trademark wasn't registered in one country, which allowed a competitor to register the trademark and prevented the firm that should have registered the mark from using a well-known brand.

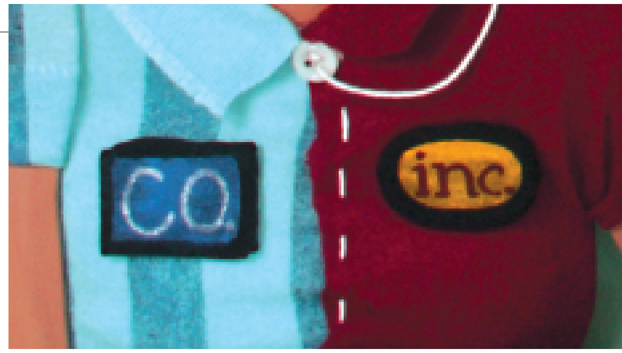
Knowledge of contract and continuing responsibilities of the vendor ("vendor warranty") is also critical. We were involved in an acquisition where there was a sharp decline in sales after the acquisition. The newly appointed finance manager became aware of a contract that indicated there would be recourse to the vendor if the company could prove that sales had been falsely inflated prior to acquisition. The finance manager was able to prove that the vendor had falsely inflated sales and ultimately earned recourse of about $1 million.

Questions for management to consider:

- Have there been past issues involving fraud?
- Do the two firms have similar policies related to expensing vs. capitalizing costs?
- Have you identified provisions for doubtful accounts?
- Are there any conditions in the acquisition contract that need to be met?
- Are you confident you have identified all potential commitments?
- Have you identified leased assets?
- What are the days' sales in receivables by customer type and customer?

4. Ensure Adequacy of Financial Controls

Identify financial controls, and ensure they are compliant with SOX. A review of the control environment outlined during due diligence must be thoroughly understood. It's extremely important to examine the regulatory framework within which you will be operating. One of the first activities is to obtain or establish a list of current authorities schedule and communicate a new authorities listing to all concerned. The authorities schedule might include areas such as: bank mandates, hiring and firing, fixed



asset acquisition and disposal, write-off of inventory, investment decisions, list of bank signatories, and individuals who can make legal representations on behalf of the business. In one acquisition the authorities schedule was very detailed (45+ pages). As a result, neither staff nor management understood it, so they weren't capable of monitoring it effectively for compliance.

It's critical to meet with internal and external auditors to review the control environment. Any deficiencies identified must be rectified within aggressive statutory reporting deadlines because material noncompliance can have serious implications for management. As an example, are there any regulatory issues in Social Security, legal or capital structures, or withholding taxes?

Questions for management to consider:

- What are the companies' ethical codes of conduct?
- Has a process been identified to ensure codes of conduct have been communicated and understood?
- Is there a Sarbanes-Oxley coordinator?
- Are SOX policies communicated clearly and documented?
- Do individuals understand their levels of authority?
- Have you identified and reviewed areas that are deficient?
- Has a plan been developed to rectify deficiencies?

5. Review Information Technology Systems

Integrating two or more IT systems can be incredibly complex, if not impossible, so it's critical to provide sufficient attention to understanding the IT systems and potential shortfalls. It's also important for the acquiring company to identify the existing and future state of technology platforms and architecture. The main objective is to ensure that the computer systems and the IT environment enable the business to process its data in an appropriate, efficient manner with due regard to security and integrity. The key risks to the business in the area of IT are business interruption, loss of data, inaccurate or

Figure 3: Information Technology

unauthorized changes made to application software or data leading to a loss of data integrity, and fraud. Information-technology-related controls must be considered over individual applications, such as the General Ledger application, the Accounts Receivable system, and the Inventory system. In many cases, fully integrated accounting systems exist, and controls may deal with organizational aspects of the IT environment as a whole.

It goes without saying that information technology is of vital importance to the day-to-day function of the business. The accounting transaction systems and controls should ensure that:

- Access to IT functions is restricted with job specifications,
- The data input is correctly processed,
- Rejected data and suspense items are isolated, and
- Output reports reflect the correct financial position and results of the company.

Figure 3 lists the most common controls for each process that may need to be implemented. These controls need to be tailored and prioritized to meet each individual situation.

Questions for management to consider:

- Will an IT manager be on site, or will you share IT resources?
- Is there an adequate disaster recovery system?
- Has there been an IT security review?
- Have the auditors reviewed the transaction systems and accounting applications?
- To what extent will the transaction systems and accounting systems be integrated? Over what time frame?

6. Integrate Financial and Management Accounting

Integration of accounting systems can be difficult. During one acquisition we spent many months converting accounting policies, procedures, and forecasting systems to ensure consistency with the acquiring company's policies. As a first step, determine deadlines for internal and external reporting, and discuss IT capabilities. Then prepare to merge systems as soon as possible. Develop consensus regarding key performance indicators, and determine if these are currently prepared at both firms. Identify any significant differences in local reporting requirements. The General Ledger provides the basis for accurate and useful accounting information. The company must move as quickly as possible toward reporting actual results from the General Ledger and thus eliminating time-consuming reconciliations and potential for error.

Questions for management to consider:

- Will IT support the planning process?
- How realistic is the budget and phasing process?
- Are reporting deadlines communicated and understood?

7. Assess Progress, and Perform Post-Integration Analysis

Ample evidence suggests that the management of acquiring firms often overestimates the synergies that will result from an acquisition. An important step, especially for firms that acquire firms regularly, is to measure the actual synergies post-integration. For example, in the case of a product extension type of acquisition, the acquiring firm usually projects savings from the combined distribution of products to the same end customer—e.g., a potato chip company acquiring a producer of candies or nuts. It's important to quantify this potential savings (e.g., a 2.5% reduction in distribution costs) over a timeline and then measure the actual savings post-integration. This is an example of recurring savings from an operational synergy.

There are also one-time savings from synergy. Using the same example, it might be feasible to eliminate one warehouse in the distribution system as a result of combining the two product lines. It's important here to distinguish one-time savings from recurring savings. This information can then be used in strategic decisions and to assess future deals. Firms may want to use this information in developing a balanced scorecard or other strategic performance management and measurement tool.

This post-integration audit should be in addition to regular (quarterly) assessment of progress toward goals developed in the overall integration plan.

Questions for management to consider:

- What level of synergy is required for the acquisition to provide value?
- If the synergies were less than expected, why?
- Can these synergies be replicated in future acquisitions?

ACHIEVING SUCCESS

As more and more companies use mergers and acquisitions as a vehicle for achieving growth and implementing strategy, the ability to successfully integrate businesses becomes increasing relevant. We hope the seven steps we have outlined to facilitate the integration of the finance function will help you understand the process and make it easier. Acquisitions require particular attention to due diligence and contracts. Communication and transparency throughout the entire process build trust and are instrumental in retaining key personnel, integrating business operations and cultures, and achieving synergies. ■

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