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How CPAs Can Help Loan Officers Assess Business' Risks, Valuations

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When an entrepreneur needs money, there are many places he or she can go. Between crowdfunding platforms and venture capitalists, the fundraising business has become increasingly crowded. Despite the competition, the traditional bank loan remains appealing because it's often backed by a trusted institution with protections offered by the federal government. This level of trust, though, comes with a price.

Loan officers are leery to give their bank's money to any start-up off the street, and they won't accept an applicant's valuation based solely on their rose-colored glass pitch. There needs to be a proven track record of success even if it's just the past 12 months. There should be a clear and reasonable plan to grow the business. Most of all, there needs to be solid financial data – preferably prepared and endorsed by a professional.

Growth projections always mean more to a loan officer if an independent CPA confirms them. As auditors, we take on a fiduciary responsibility to verify each client's financial records – their tax returns, income statements and each line of the balance sheet. We also scrutinize revenue projections based on a variety of business and market factors such as consumer demand and the entrepreneur's go-to-market strategy. We review financial assumptions being made for reasonableness.

One aspect that is often overlooked is how the company will reach its customers. Without a comprehensive marketing and public relations strategy, many companies will not be able to scale at a reasonable rate, and that missing piece could raise the risk level for a loan officer. It might be enough risk to hike the interest rate, reduce the valuation or, worse, kill the financing deal all together.

Other key factors, such as accelerated depreciation of assets or research and development tax credits, might be overlooked by some of the most financially savvy business owners. The best advice we can give is for them to filter their tax and accounting through the experienced eyes of a highly trained and experienced CPA. The CPA can provide the expertise necessary to maximize incentives that will increase the business's working capital, which ultimately reduces the credit risk to the bank. I've found companies that take the necessary time and effort to identify and maximize certain tax and other incentives with the guidance of a

CPA are in a much better cash position to increase their credit line or obtain other financing from their bank.

By the time it gets to the bank, a fully vetted loan application should read as a blue print for paying back the bank's money.

The Hunt for Risk

Whenever the numbers don't add up – or appear too good to be true – it affects the valuation of the company's assets, but by how much? I've found that sloppy bookkeeping can cut a company's valuation substantially, sometimes up to 20 percent or more.

Like accountants, loan officers are doggedly hunting for risk all day long. Some are hidden on the 107th page of an applicant's balance sheet, or in a note from the 1990s. Others could be quite obvious, but only if you have the experience to know how to look for it.

Here are some examples of possible red flags:

Delayed tax returns: While most companies are entitled to an automatic six-month extension, delayed tax returns could make it challenging to put a price on assets. Without the most up-to-date tax return, the valuation may be based on data that does not reflect the company's current worth. In today's world, banks base their lending on the most recent tax returns.

History of audit failure: An old and relatively minor error in bookkeeping could still come back to haunt an entrepreneur. How can a bank fund a business if its new treasurer had once been cited by regulators? It's a tough assessment to make, but one that can be eased if there's a solid and well-reported history of financial performance following the initial error.

Path to growth: Most entrepreneurs are optimistic thinkers by nature, but that confidence can become foolishness if it's not checked by someone with the proper financial and marketing acumen. One of the main elements to scrutinize is the company's customer acquisition cost – what a new business plans to spend to get the word out and close new accounts. It's one of the most underestimated expenses of a new business and also one of the most critical aspects to address if the applicant is going to scale and make good on their loan.

Marginal new product development activities: It goes without saying that companies need to continue to be on the technical forefront of their industry to remain competitive. Companies that don't clearly show this level of acumen are a greater risk for the bank, because sustaining the revenue stream that would provide the ability to pay back the loan could be in question. On the other hand, companies that embrace new product development and innovation strategies and the tax incentives that follow provide the bank with a greater level of comfort by demonstrating their exploitation of a unique niche that is ahead of its competition.

Conclusion

When it comes to determining whether or not a bank should consider lending to a company, a CPA is the one of the most valuable resources. The terms of each loan should be calculated based on verifiable valuation metrics and a fair risk assessment. If done properly, the application process will benefit both the applicant and the lending institution.

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