



How businesses are confronting governmental licenses in M&As

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Survey: How businesses are confronting governmental licenses in M&As

The results of a recent survey conducted by Compliance Week and Avalara found most businesses consider governmental licenses as part of due diligence efforts during mergers and acquisitions, yet the opportunity for risk management improvements remains. **Kyle Brasseur** has more.

With all the moving parts of mergers and acquisitions (M&A), governmental licenses often get lost in the shuffle. Lack of federal oversight on licenses might lull businesses into a false sense of security, believing the ramifications of noncompliance to be tolerable at worst.

But part of an M&A subject to the whims of thousands of licensing jurisdictions should not go ignored. Cities want to know who is doing business within their borders. Counties are going to have safety concerns that vary by industry. The risk is death by a thousand cuts, which can serve to cripple post-acquisition momentum or result in significant business disruptions.

“Putting out tiny little fires all over the country—is that what you want to be doing after your M&A?” said Alan Ruttenberg, senior product marketing manager at Avalara, a tax compliance software provider.

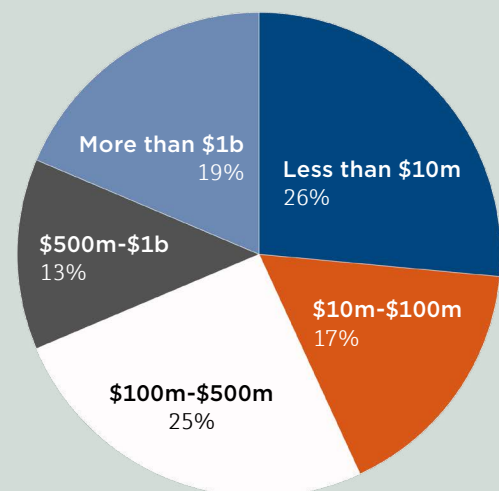
Avalara and Compliance Week polled 102 risk, compliance, and accounting and audit professionals as part of a survey on M&A pain points conducted from July through August. Of the respondents, 17 percent represented the financial services industry, followed by manufacturing (8 percent), technology (8 percent), energy and utilities (7 percent), and healthcare (6 percent).

More than half the respondents (69 percent) indicated the largest M&A they’ve been involved in totaled less than \$500 million. Another 19 percent said more than \$1 billion. Respondents overwhelmingly selected horizontal mergers (69 percent) as the most common type of M&A they’ve experienced.

When asked if governmental licenses are part of their

current due diligence process, 68 percent of respondents said yes. Andrea Jaffe, senior director in the professional services organization at Avalara, expressed pleasant surprise toward this total, noting for some industries, like technology and software, licenses are not prevalent. Still, she said, even the smallest license risks can have “cascading effects,” empha-

What is the largest M&A you have been involved in?



sizing the need for all businesses to educate themselves on the matter.

Lorraine Cody, lead consultant at Avalara, offered the following example: A restaurant chain is buying back 100 locations from franchisees. Low on its priority list might be permits related to the alarm systems at each building. In the process of transferring ownership, the restaurant chain might find some of those buildings didn't pay thousands in false alarm fines and now inherits the responsibility of paying those penalties.

"In some cases, the authority doesn't really care—they just want your money," said Cody. "In that respect, what's happening is if you didn't build into your M&A documentation that there would be some sort of payment provision for outstanding fees or fines or things of that sort, you don't have a remedy against the seller. Once you take ownership, you're guided by whatever your purchase or acquisition documents say."

These threats underscore the need for every business—regardless of the risk level it faces—to work protective language into its M&A documentation.

"When there's a change of ownership, many authorities

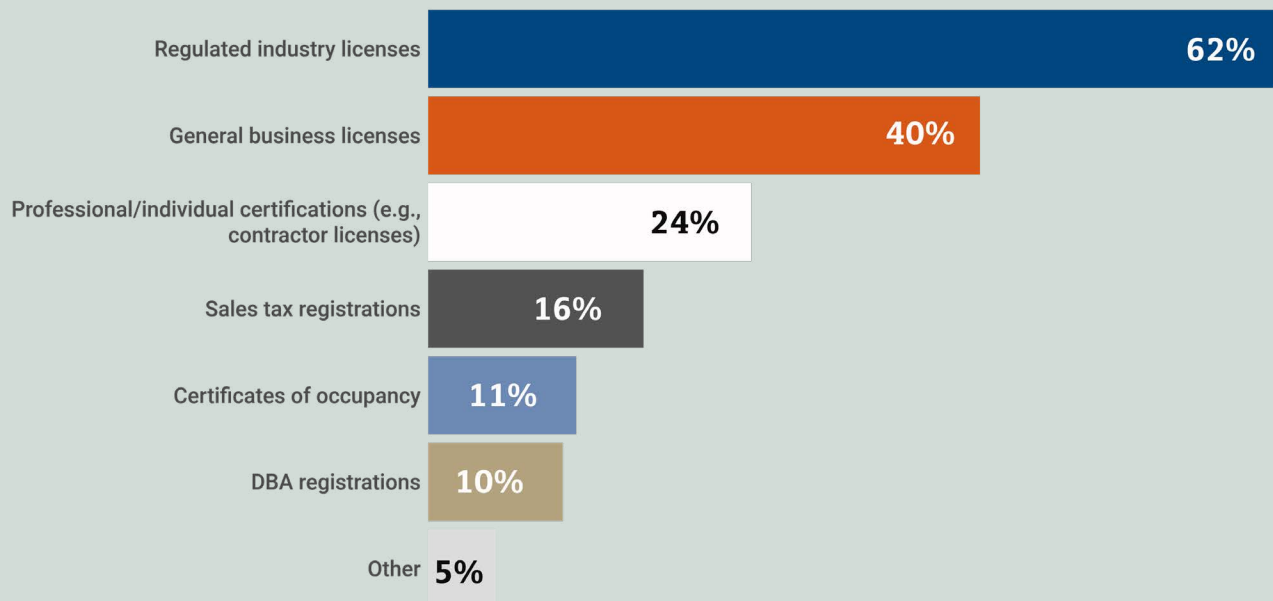
"Financial reserves are warranted when there's a higher risk of financial cost, but in all cases protective language should be there in case something arises unexpected or unforeseen."

Andrea Jaffe, Senior Director, Professional Services, Avalara

decide at that time to bring you up to code," said Cody. "I don't think a lot of businesses as they're going into an M&A really have that in the forefront of their mind—that this is going to trigger things to that extent."

Of the survey respondents, 31 percent said they set aside financial reserves for potential noncompliance incidents during an M&A. How much they said they set aside varied,

During M&As, what types of governmental licenses present the biggest challenges? (Select up to two)



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Lorraine Cody, Lead Consultant, Avalara

with some responses surpassing \$1 million for industries like construction and agriculture where licenses are closely regulated. Setting aside reserves like this could be considered a best practice but might not be mandatory if the right language is included from the outset of a deal.

“Financial reserves are warranted when there’s a higher risk of financial cost, but in all cases protective language should be there in case something arises unexpected or unforeseen,” said Jaffe. Each deal should be assessed on the risk level relevant to the industry involved, she said.

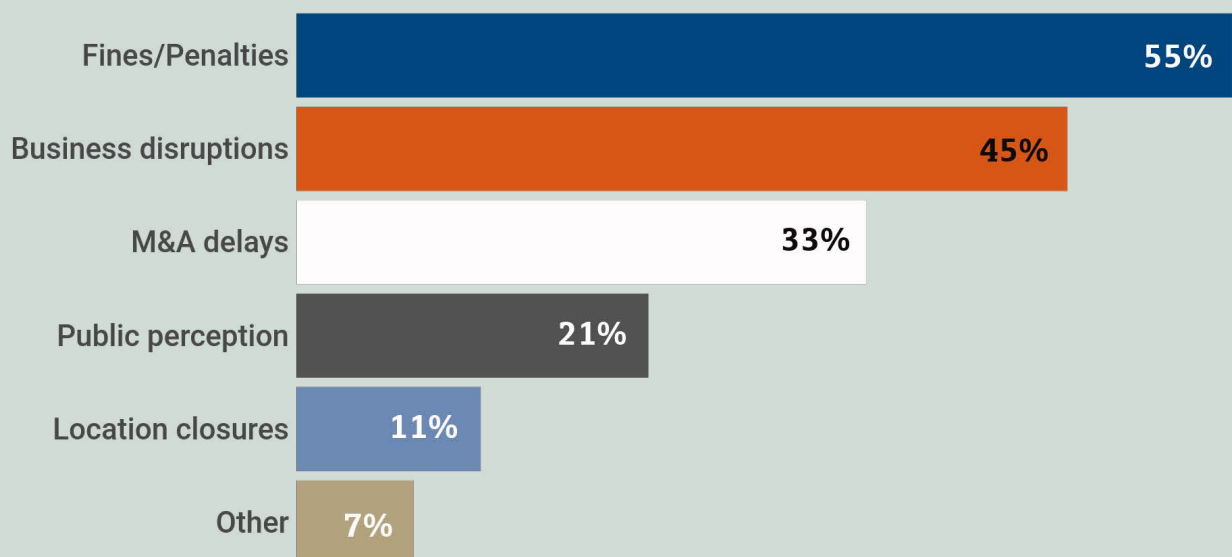
Risk mitigation measures

Getting ahead of licensing risks requires foresight. Asked at what stage of an M&A do they start considering governmental license due diligence, an even split of respondents—30 percent each—said “early” or “throughout.” Only 9 percent of respondents said “late,” while another 30 percent found the question not applicable.

“Earlier is always better,” said Jaffe. “... If you want to be able to operate on Day 1, the focus has to be on how we can get licenses in place without operating disruption.”

Business disruptions (45 percent) ranked behind only

Which potential dangers of governmental license noncompliance that can occur during (and after) an acquisition do you most worry about? (Choose up to two)



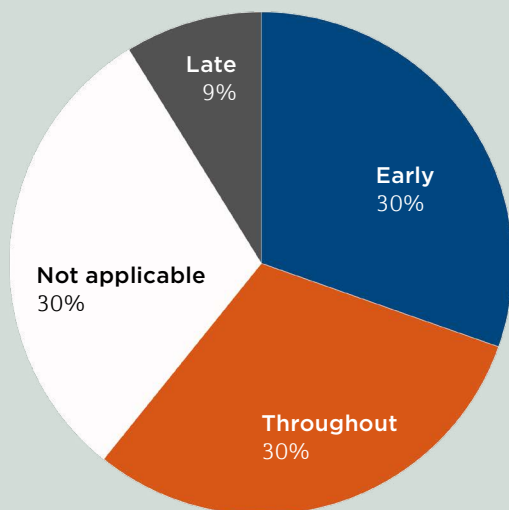
finances and penalties (55 percent) when respondents were asked to select up to two answers from a list of dangers of governmental license noncompliance they worry most about. Cody and Jaffe each were surprised disruptions did not rank highest.

“As much as they can fine you—and they can fine you a lot—your fine is only going to be a fraction of the dollars involved,” Jaffe said. “If you can’t sell something, you can’t make the bigger amount of dollars.”

An issue with licensing at many businesses is that nobody wants to own it. Regardless, risk managers have a role to play in supporting compliance efforts. Jaffe advised risk professionals should “get closer to the ground on licensing” and ensure operations staff feel comfortable. Doing so can help reduce the threat of the headaches that occur when licensing issues stand to hold up an important acquisition.

“The earlier you get in front of the licensing, the happier the risk management, accounting, and real estate people will be,” she said. ■

If governmental licenses are part of your current due diligence process, at what stage of an M&A do you start addressing them?



The logo features the word "Avalara" in a white, bold, sans-serif font. The letter "A" is stylized with a white checkmark inside its upper left portion. The background consists of several overlapping, semi-transparent orange shapes that create a dynamic, geometric pattern.

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