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Access to Capital: Current Outlook

Obtaining financial capital has certainly been a hurdle in the last eighteen months. What does the year ahead look like? We asked three top financial executives to share their perspectives: Thomas A. Avery, Managing Director, Raymond James & Associates, Inc.; James S. Grien, Partner, TM Capital Corporation; and Randy Karchmer, Co-Head, Mergers, Acquisitions & Financial Sponsors, Morgan Keegan & Co., Inc.

What is the outlook in 2010 for raising debt/equity with banks, private equity and IPOs?

AVERY: I see the year continuing to improve from what was a low point in the third quarter of 2009. The banks have opened up a bit. We've seen the first pickup in private equity activity just in the third quarter. The number of IPOs, probably the best known or watched of the indices for financing activity, have picked up considerably here toward the end of the year, so we've done considerably more in 2009 than we did in 2008.

GRIEN: We are seeing a palpable change in the attitude of middle market lenders toward transactional lending. Middle market lending is clearly loosening. There is still an awful lot of uncertainty in the private equity market around who will survive and who will not, and a lot of pent-up demand among private equity firms to commit capital. With respect to the IPO market, it's also a mixed bag.

KARCHMER: Starting with the private equity world, huge amounts of capital were raised in '08 and prior, and that money needs to be put to work. As it relates to the debt side, that market shows signs of life, although we are not fully there. Once that does fully open,

you'll start to see some true cash flow loans. The high-yield market as we sit here today is very vibrant and will continue to be. The leveraged lending market is beginning to show signs of life. It remains to be seen how vibrant and deep the IPO market can be.

What are your views on how the impact of a downturn in commercial real estate will impact raising debt or equity?

AVERY: You can't expect new construction or development until the current glut is filled, especially here in Atlanta. My guess is the banks have been slow to write down loans and property just because of the problems on the residential side. I think it's going to take a while longer.

GRIEN: Keep in mind that the commercial market is a fraction of the size of the residential market. My own theory is that, unlike the residential collapse, the commercial market collapse has been baked into the market to a large extent already. I think the debt market, in particular, has done a much better job of anticipating a significant downdraft in asset values in the commercial real estate market than it did in the residential market. This is just an armchair speculation, but you could make a case that maybe there's even more upside than downside because the market really has factored in all the gloom and doom already in the way it's pricing real estate debt.

KARCHMER: If, in fact, that does come to pass, it will certainly put a damper on any forward momentum. If unemployment remains high and we end up double

IT Risk Management

By Dan Schroeder, CPA, CISA, CIA, CISM

While IT control requirements for SOX 404 compliance are important, they represent a small subset of IT risk considerations for a public company. Other significant sources of IT risks are numerous, including operational risks, privacy, identity theft, SAS 70 reporting, PCI compliance, confidentiality, DRP / BCP, system availability, network and application security.

Often, a challenge for public companies is how IT risks can be managed across the enterprise and balanced against the company's business needs. Without an integrated approach, executives and audit committee members cannot be confident that IT delivery and support is aligned to business needs and IT risks are being cost-effectively managed. The following is the ideal approach:

1. Define the role of IT in the support and enablement of the business model and strategy.
2. Establish overarching control objectives that reflect management's expectations for the delivery of IT services and the management of IT related risk.
3. Identify threats that could impede on the fulfillment of those control objectives. Prioritize those risks based on compliance requirements, impact on operations and likelihood of occurrence.
4. Define policies, procedures and system-based controls needed to mitigate risks and fulfill the control objectives at business unit and consolidated levels.
5. Prioritize remediation efforts based on an overall view of risks and controls.
6. Establish a monitoring program that reflects criticality of various controls and meets the needs of senior management and the audit committee.

When defining risks and controls, use common terms and statements to promote consistency and consolidation.

Most public companies rely heavily on IT to fulfill their business model. The risks represented by IT increase with the use of IT. By deploying this overarching approach, companies can improve the effectiveness and efficiency of IT risk management.

Dan Schroeder is a Partner with Habif, Arogeti & Wynne, LLP. Contact: dan.schroeder@hawcpa.com.

Seminar

Financing Your Business: Identifying Sources of Capital in Today's Credit Environment

A panel discussion with three executives who are assisting their clients in obtaining the capital they need to operate and grow their businesses in today's challenging financial environment.

Featuring

James Grien, Partner, TM Capital Corporation

Thomas Avery, Managing Director, Raymond James & Associates, Inc.

Randy Karchmer, Co-Head, Mergers, Acquisitions & Financial Sponsors, Morgan Keegan & Co., Inc.

Tuesday, February 2, 2010

Networking & Breakfast: 7:30 - 8:15am Panel Discussion: 8:15 - 9:15am

Maggiano's - Buckhead

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dipping into a recession, all bets are off. New development will certainly be difficult to finance.

Are you seeing the “models” used by financial buyers changing with respect to how much debt/equity or mezzanine financing is required?

AVERY: I’ve seen a good bit of change this past year. The volume of deals is down because of the lack of availability of debt or credit. Companies that had to do something have been sort of forced to do a transaction, so there have been many distressed situations where a lot of capital is poured in. But the typical growth company that’s doing well and wants to raise growth capital or take the opportunity to sell the business and recognize a return, has more or less stayed on the sidelines this year because it’s not a good time to be out there.

GRIEN: Absolutely. There’s a real incentive to put money to work and financial buyers are taking advantage of lower multiples. Investors are clearly buoyed by the fact that they’re able to enter investments today at significantly lower multiples than would have been the case 18 months ago. And I think they are taking advantage of that by using significantly more equity. They feel like they can generate returns with less financial engineering, so they’re proposing transactions with significantly higher equity checks as a percentage of the total capitalization.

KARCHMER: The amounts of debt that can be put in these transactions is materially lower than it was, so return thresholds are coming down and private equity firms are having to put in more equity as a percentage of the transactions as compared to debt. In light of the difficulty in finding debt financing, a lot of firms that wouldn’t make pure minority equity investments in the past may be very willing to do so now.

With the weakening of the U.S. dollar, what are your thoughts relating to inbound investments?

AVERY: Like us, most countries have their own share of problems to deal with. If the U.S. dollar continues to weaken, we’ll probably start to see the world economies come out of recession. From

the data and statistics I’ve seen, it’s not been hugely noticeable yet.

GRIEN: We clearly see a significant interest among foreign strategic acquirers in accessing U.S. assets. Given the dollar’s value against world currencies, we are essentially running a half-off sale on the U.S. economy. I think they are particularly optimistic about investing in the U.S. right now because the clouds on the economic horizon are beginning to lift a bit, so they feel that there’s a bit more visibility now regarding the performance of assets that they may be acquiring.

KARCHMER: We continue to see a lot of interest in U.S. companies from foreign strategics. However, a sole determinant to do a deal or not here in the U.S. isn’t going to be predicated on what’s going on with the exchange rate. The business case still has to make sense. The added benefit from the currency is just that, an added benefit.

What impact will the proposed legislation to defer or permanently eliminate the implementation of SOX 404 for smaller companies have on the IPO market?

AVERY: Companies and the private investors that back them have not wanted to deal with the cost and anxiety of trying to comply with SOX, not to mention the various liabilities that you take on when you become a public company and a director of a public company. How you quantify that I don’t know because it was hard to tell, with all the other problems we’ve had, how much of an impact you’ve really had in keeping companies away from the IPO markets.

GRIEN: Unless Sarbanes-Oxley is rolled back significantly, we won’t see a real emergence of a vibrant IPO market for mid-market companies.

KARCHMER: SOX has been just one more reason for smaller companies not to go public, but there are a whole host of other reasons why companies choose to go public or not. Certainly on the whole, a deferral will be helpful.

Learn more from Tom Avery, Jim Grien and Randy Karchmer by attending HA&W’s February 2nd seminar, “Financing Your Business: Identifying Sources of Capital in Today’s Credit Environment.” (See announcement on page 2.)

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Revenue Recognition Changes

By J. Marc Welch, CPA

The release of Accounting Standards Updates No. 2009-13, *Multiple Deliverable Arrangements* and 2009-14, *Certain Revenue Arrangements That Include Software Elements*, will require many companies to adopt revenue recognition policies that result in accelerated revenue recognition on bundled sales of goods and services. Technology companies, which often sell software, hardware and services together, will likely incur the biggest impact.

Under the old accounting rules, bundled arrangements were either accounted for under EITF No. 00-21 (ASC 605-25) or SOP 97-2 (ASC 985-605) and revenue for a delivered item could not be recognized unless the company had established vendor specific objective evidence (VSOE) of fair value for all undelivered items. This would often result in a significant revenue deferral.

The new standards allow for separate

revenue recognition based on the company's best estimate of selling prices when no VSOE can be established. This will likely allow companies to recognize revenue earlier than under the prior rules.

Transactions that are primarily software sales will continue to be recognized under their own recognition standard. Sales of tangible products containing both software and non-software components that "function together to deliver the product's essential functionality" is now excluded from the software rules and included under the new standards.

Companies will be required to adopt these standards for transactions entered into in fiscal years beginning after June 15, 2010, but early adoption is permitted.

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