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Private firms meet tougher standards

Many see advantages to Sarbanes-Oxley Act accounting regulations

BY ANNE FIELD
The New York Times

Even as some publicly traded small businesses are going private to escape the tough accounting standards stipulated by the 2002 Sarbanes-Oxley Act, a growing number of privately held companies are rushing to incorporate them, even though they do not have to.

These companies, which are exempt from the law's requirements, nevertheless see advantages in adopting them, as well as in instituting other corporate-governance changes like adding outside directors to their boards. Having witnessed the collapse of corporate giants like Enron, whose accounting malfeasance and weak management oversight inspired the legislation, these companies have a heightened appreciation of the need to strengthen their defenses against corruption, experts say.

They also know compliance with Sarbanes-Oxley is a precondition for going public, being acquired or raising money from venture capitalists.

"Sarbanes-Oxley has raised the visibility of these issues," said Jeff Westphal, president of Vertex, a tax software and services company in Berwyn, Pa.

It certainly has for Chris Winfield, president of 10E20, a Web-design start-up in Brooklyn, N.Y. Winfield has spent the last few months searching for affordable software to help his company follow Sarbanes-Oxley's accounting rules, even though it is privately held and had only \$2 million in revenue last year.

Winfield has ambitious plans for growth, including an increase in the number of employees to 200 by 2006 from 28 today, and he wants to be ready to tap the stock market or put his company up for sale when the time comes. If he cannot find the right software program, he says, he will have his staff create one and integrate it with the company's accounting and back-office systems, a process that could take up to eight months.

"I think we have to get the ball rolling now," Winfield said. "It will definitely be worth the effort."

Sarbanes-Oxley created a regulatory board with broad

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Companies adding outsiders to their boards

powers to crack down on corporate accounting abuses, toughened corporate disclosure requirements, established protections for corporate whistle-blowers and required changes in the makeup of corporate boards.

Since its passage, a growing number of small publicly traded companies have announced plans to go private, in large part to escape the cost of compliance.

By the same token, the law has prompted many small companies to head in the opposite direction. According to Andrew Keyt, executive director of the Loyola University Chicago Family Business Center, more private companies are adding outsiders to their boards and introducing formal financial audit and compensation committees. They are also holding board meetings more often, he says, and taking a more critical look at the directors' performance.

In a 2003 survey by his organization of 3,000 mostly small businesses, 38 percent of boards met three or more times a year, up from 28 percent in a similar poll of 1,200 businesses in 1997, he said, while only 36 percent were satisfied with their board's

contributions, down from 42 percent six years earlier.

Keyt believes the economic downturn, which many companies have only recently started to dig out from, has played a role in private companies' new corporate governance religion. "When business performance is down, shareholders are more concerned about the performance of the company," he said. "Corporate governance becomes more important."

Shane Pliska is a case in point. Pliska joined Planterra, his family's 30-year-old interior-landscape-design business in West Bloomfield, in 2003, two years after the company experienced a 20 percent decrease in sales. He decided to introduce more frequent and more formal board meetings partly because "the economic downturn made us look to how we could change things to make them better," he said. "When you're making a lot of money, you don't really think about that."

Craig Aronoff, a consultant with the Family Business Consulting Group in Marietta, Ga., says he is helping at least a half dozen small private companies set up boards

of directors. The key, in many cases, is finding people with expertise in specific areas in which the businesses need help.

"You need a board that can show you how to grow the company," said Marc Morgenstern, managing partner with Kahn Kleinmen, a Cleveland law firm. "Identify five or six skill sets, like sales or technology, find people who have them, and then let them challenge your assumptions."

Recruiting such talent takes persistence. Two years ago, Westphal of Vertex decided to look for outsiders to expand a board that consisted of his father, his mother, two sisters, his lawyer and himself. At an awards dinner one night, he spotted Richard Teerlink, the retired chairman of Harley-Davidson who is largely credited with turning its fortunes around through strong leadership and an emphasis on worker empowerment, and invited him to lunch. He arranged a second meeting a month later and persuaded Teerlink to act as unofficial consultant to his company. One year after that, Teerlink agreed to join the board.