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IN DEPTH: PUBLIC COMPANIES REPORT

Going private: Compliance costs scaring SOX off small business

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Ask any CEO of a small to medium-sized business in Texas what tops his list of concerns for 2005 and most will rank compliance costs associated with the Sarbanes-Oxley Act as No. 1. Since the passage of this act in July 2002, no one in corporate America has felt the effects of this legislation more than small, publicly traded companies.

Costly compliance

Over the past year, the cost of being a public company has increased by more than 150 percent as a result of new federal regulations, and there seem to be no signs of letting up as companies are forced to absorb annual compliance costs. Some companies report spending upwards of \$2.5 million to comply with Section 404 alone of Sarbanes-Oxley, which requires executives to certify that a company's financial reporting practices are legitimate.

The requirements of Section 404 are forcing many companies to change the way they do business, including procedural changes on everything from maintaining accounting records to reporting financial statements. In addition, to ensure the proper checks and balances are in place, some executives are spending between 40 percent and 80 percent of their own time on compliance measures. For a small business with limited resources, the lost man-hours equates to lost revenue.

If these costs weren't enough of a burden, many companies are forced to seek outside help from auditors, lawyers and consultants to ensure accuracy. These advisers don't come cheap either; some charge more than \$400 an hour for their services and expertise. While larger companies usually have a whole arsenal of experts on staff, these costs must be paid entirely out-of-pocket by small companies.

Going private

Even with all the proper controls in place, many businesses are deciding that staying public is simply not worth the risks or costs involved. According to a recent survey by Grant Thornton International, the number of public companies announcing plans to go private increased by about 30 percent in the 18 months after Sarbanes-Oxley went into effect. When given the choice of pouring dollars and resources into compliance measures or putting that money back into the business, more CEOs are putting their foot down.

Texas-based companies who have recently made the move from public to private include Emergisoft, a hospital equipment and hardware company in Arlington; and KBK Capital, FFP Partners LP and Calloway's Nursery, all based in Fort Worth. After evaluating the advantages and disadvantages of their corporate status, other smaller, private companies in the area are dropping plans to go public, citing compliance costs and a steady stream of new government regulations as reasons to remain private.

Unintended effects

Scaring companies into private holding could have some dangerous repercussions on the economy as a whole. By preventing investors from buying a stake in small businesses and starting a foundation of future successes, we could be threatening capitalism and continued U.S. productivity.

While many critics of Sarbanes-Oxley are quick to speak out about its faults, there are many supporters of this legislation who say new regulations are already having a positive effect on the way they do business. Many companies have been forced to adopt better financial controls now, rather than later, in hopes of preventing SOX-related audits.

This might offer some solace for those Texans who were hit especially hard by the collapse of Houston-based Enron Corp. However, many view Congress' reaction to Enron, WorldCom and others as knee-jerk and too far reaching. Critics of the act say regulators are punishing the masses for the mistakes of a few.

The uncertainty surrounding this legislation, especially its impact on small businesses, is already having a "chilling effect" on operations in boardrooms across the United States. CEOs at companies of all sizes are, in many cases, so intently focused on legislative issues that they have been distracted from fully focusing efforts on growing their business.

In response to this backlash, the SEC has already agreed to review Section 404 of the Sarbanes-Oxley Act and its effect on small businesses. (See story, Page 25.) The agency announced the formation of an advisory panel in December of last year that will consider its effects, but it might be too soon to tell. Most small businesses are not required to be in compliance with Section 404 until the end of 2005.

Through the good, the bad and the ugly, we will have to wait to see the final outcome. Until then, the argument rages on, with supporters and detractors equally vocal. More than likely, we will see an end result somewhere in the middle of the spectrum that will hopefully encourage ethical reporting and credible business practices for small businesses and multibillion-dollar companies alike.

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