

## Getting savvy about Sarbanes when it comes to M&A

How much of a burden does The Sarbanes-Oxley Act place on private, middle-market businesses — particularly on their potential merger or corporate-development activities? And how important is it for private companies to become “SOX-ready” to prepare themselves for sale?

Sarbanes-Oxley has had a far-reaching impact on public companies. Developed with good intent — to elevate governance standards in the wake of the inquiries into flawed practices at companies such as Enron and Tyco — SOX has been assailed for going too far. That’s been especially true for small public companies and those considering IPOs.

The Association for Corporate Growth (ACG) recently joined forces with Thomson Financial to survey nearly 1,600 deal-makers nationwide. At about the same time, Mirus Capital Advisors polled attorneys who are involved in all facets of M&A transactions.

The key conclusion: SOX complicates deals. Seventy percent of deal-makers nationwide say their due diligence costs have increased over the last year, according to ACG, and 86 percent note that the cost and transparency required under Sarbanes-Oxley is a concern for taking a company public or remaining public. Even if they have no intention of going public — and even if a sale isn’t in the immediate future — owners and managers of private, middle-market businesses need to become savvy about SOX,

and quickly.

Financial buyers (chiefly private equity firms) and industrial buyers are increasingly applying SOX-like criteria to acquisitions of smaller private companies. Due diligence phases are stretching out, and cautious acquirers are asking questions that as recently as two years ago never came up. Although few of the factors now under scrutiny are deal-killers, they can easily distort the valuations that



### INSIDER VIEW

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sellers of private businesses can expect. And of course they are adding friction and cost to deal-making processes.

The Mirus poll first tested the extent to which private companies are currently pursuing SOX compliance — or SOX readiness, at least — in preparation for a sale of the business. The dominant feedback: There is little apparent activity. Yet more than a quarter of the attorneys said the Sarbanes-Oxley Act affects between 50 percent and 75 percent of M&A deals that involve private companies. A deal may not be imminent, but buyers are looking for liabilities by poring over financial and governance histories — not just the target’s recent statements.

Private-company managers who think that SOX is simply a bump in

the road should think again, according to Mirus’ study. Even though a minority of the attorneys polled thought that public companies are less inclined to pursue private acquisitions because of the rigors of Sarbanes-Oxley compliance, nearly two-thirds said that SOX has made public buyers more risk-averse when considering private targets.

So what should private-company leaders be doing to become smarter about SOX? Recommendations mentioned most often by attorneys include the following:

- Study the “good business practices” that SOX has brought to light.
- Focus on improving internal control activities and the internal audit function (documentation is key).
- Implement strict policies regarding the auditor’s role and capacity.
- Revamp the corporate code of ethics.
- Develop a formal whistle-blowing policy.

Mirus’ study of M&A lawyers’ views is just the starting point. But it sheds light on the road map for owners and managers who are thinking of selling the business. SOX is not about to be scaled back.

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