Ideas for Your Success

Third Quarter 2009

Investing during difficult market conditions

In the midst of the greatest economic downturn since the Great Depression and because of the overall volatility of the stock market, investors are likely experiencing sleepless nights. During these difficult economic times, it's important to remember that challenging market conditions can provide smart investors with potentially rewarding investment opportunities.

Reconsider before selling stock

If falling stock prices are causing you to think about selling some of your underperforming stocks, think twice. There are, of course, good reasons why you might want to sell certain positions — if, for example, you've identified better investment potential elsewhere or you want to realize capital losses to offset future capital gains.

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But if you're selling only because you're worried about stock prices falling even further, it's usually a bad move. When you liquidate otherwise good stocks in decline, you lock in losses with no hope of recovery.

Assuming your investment time horizon is long enough to wait out a downturn, take comfort in the fact that, despite considerable short-term volatility, the market has historically risen over the long term. If your time horizon is relatively short, however, make sure you work closely with your financial advisor to determine the best portfolio mix for your age and risk tolerance.

Search for bargains

When the overall market drops, it takes many different kinds of stocks with it. Sometimes the reasons behind an individual stock's price drop are rational, such as weaker earnings, management troubles, or a worsened outlook for the future. But at other times, a stock may fall even when its underlying business remains solid.

This can be an opportunity for attentive investors to buy shares of quality companies at a significant discount. If you're right about a firm's long-term prospect and its stock begins to rise, you have the opportunity to buy in at lower prices, thereby magnifying your potential for future gains.

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Whistleblowers protected

SOX 806 prohibits retaliation against those who report fraud

It takes courage to report a suspicion of fraud because the whistleblower may fear discrimination, retaliation or being fired as a result. A section of the Sarbanes-Oxley Act (SOX) — Section 806 — prohibits retaliation against employees who report an incident of fraud.

Section 806 defined

SOX rules apply primarily to public companies, but it's also important for private business owners to be familiar with the provisions of the whistleblower protection. Otherwise, they may find themselves in violation without even knowing it.

SOX 806 prohibits publicly traded companies from discharging, demoting, suspending, threatening, or discriminating or retaliating against a whistleblower. This includes employees who have filed a complaint or participated in or assisted with a fraud investigation.

Yes, you might say, but my company isn't publicly traded, so SOX doesn't apply to me. Don't be so sure. In some cases, the Department of Labor (DOL) has held that private businesses have been acting as agents or subcontractors of public companies and are, thus, covered by SOX.

Standard of proof not high

For employees reporting a retaliatory act, the standard of proof under SOX 806 isn't very high. They aren't required to prove fraud or even that their firing was retaliatory. Employees just need to show that they reasonably believed a fraud was being perpetrated, that they disclosed that belief to their employer or to authorities, and that they were fired within a short time after the disclosure.

If an employee meets the standard of proof, the business must prove by clear and convincing evidence that it would have fired the employee regardless of the whistleblowing. That isn't always easy to do, and sometimes the DOL may order that the employee be reinstated before there's even a hearing on the merits of the claim.

Communicate procedures

Your best bet is to avoid running afoul of SOX 806 in the first place. Be sure your employees understand how they can report suspicious activity without fear of reprisal by, for example, calling your confidential hotline. Also make certain all supervisors understand that retaliation isn't allowed.

As part of your fraud prevention plan, adopt policies that encourage everyone in the company to report suspicious activity. And revise managers' job descriptions to include SOX 806 compliance as one of their responsibilities. At the same time, limit the number of people who receive and document complaints. Keep the sharing of this information on a "need-to-know-only" basis.

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But what if you need to fire an employee who's made a whistleblower report, for reasons unrelated to the complaint? Ensure that you have clear and convincing evidence that your action isn't retaliatory, such as a record of unacceptable performance or activities, with dates, and the action taken following each incident. You may also want to discuss the situation with your attorney before terminating the employee.

Start with an ethical culture

To help avoid running afoul of SOX 806, it's wise to take steps to ensure your company is held to high ethical standards. These steps may include implementing stronger fraud controls, conducting regular audits and instituting simpler and more confidential fraud reporting opportunities. In addition, contact your business advisor to learn more about SOX 806 provisions if you're not familiar with them.

In a credit crunch?

Business financing options are available

Cash is the lifeblood of a business, but thanks to tight credit markets small to midsize companies are increasingly having trouble securing outside financing. During this difficult business environment, your company has options to secure a cash infusion.

Asset-based financing

When using asset-based financing (ABF), a company's assets, such as current assets (for example, accounts receivable and inventory) or fixed assets (for instance, plant and machinery), are used as collateral. Typically, this is done to meet either short-term (generally offered as revolving or factoring loans), medium-term (typically leasing, selling or leasing back facility and equipment) or long-term needs (usually based on real estate).

On the plus side, ABF loans can be easier to obtain than traditional loans because ABF lenders will look at hidden values on the balance sheet rather than the financial ratios typically used by traditional lenders. But ABF does have service fees and higher interest because many lenders spend time monitoring the collateral, primarily receivables and inventory.

Mezzanine financing

Mezzanine financing combines the concepts of debt and equity financing designed to satisfy short-term or interim financing needs for the expansion of existing companies.

For example, you can use mezzanine financing for new growth opportunities, mergers and acquisitions, a management or other leveraged buyout, corporate restructuring or recapitalization, or debt refinancing.

Mezzanine financing generally is easily obtainable and doesn't require collateral. But your business needs to demonstrate a solid industry track record, reputation and financial performance and present a business plan for expanding.

Options available

The double whammy of the recession and tight credit markets may be crippling your small to midsize business's ability to secure a loan. But options are available. Before taking any action, be sure to consult with your financial advisor to determine which strategy is best for your company.

Business assets require special protection

Is a significant portion of your wealth invested in a business? If so, it's important to protect your assets from unreasonable or excessive creditor claims. There are a variety of strategies you can use to protect your business assets and preserve your wealth for your heirs:

Distribute the wealth. A simple, yet effective, technique for protecting personal assets is to give them away to your children or other family members. A creditor can't go after assets you don't own. Similarly, your business can protect its assets by distributing accumulated earnings to the owners. So long as you retain a reasonable amount of working capital in the business, this strategy allows you to shield excess funds against business creditors. (This assumes that the business is conducted within an entity that allows one's personal assets to be protected from the business liabilities.)

Divide the pie. One of the best strategies for protecting business assets is to divide the business into separate entities. If certain business activities are riskier than others, consider forming separate entities to conduct these activities. Doing so allows you to limit the liability risk associated with them. Provided the entities are structured and operated properly, you can prevent creditors from going after assets owned by other entities within the group, even if they have common ownership.

Weigh renting vs. buying. Another way to protect valuable business assets is to sell them (usually to another entity created by the company's owners) and then lease them back. If done right, these assets no longer belong to your company, so they're beyond the reach of the company's creditors.

Strip it down. Equity stripping involves pledging company assets as collateral for a loan. The company then loans the funds to its owners, who protect the loan proceeds with their own personal, asset-protection arrangements. This strategy strips the company of equity, leaving less wealth exposed to creditor claims.

Finally, it's important to ensure that the company is left with sufficient funds to meet its future operating needs. If a court finds that the company is grossly undercapitalized, these walls may quickly tumble down.

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Diversify across asset classes

One way to reduce your portfolio's vulnerability in a weak market is to make sure it's diversified across a variety of asset classes. This means not only being diversified *among* stocks, bonds and money market funds, but also *within* each of these groups.

The goal of diversification is to own some investments that can be expected to outperform while others are underperforming. This can reduce your portfolio's overall volatility and minimize the negative impact of a market downturn on its value.

Reallocate if necessary

Regardless of market conditions, it's important to work with your financial advisor to assess your portfolio's health and determine if you need to reallocate your assets. Be sure to discuss how to best position your portfolio to weather the current economic storm.

Stay motivated to invest

Even the most surefooted investors can find it tough to motivate themselves to invest when markets are declining. One way to overcome this challenge is to invest a set amount of money at regular intervals to take advantage of dollar-cost averaging.

Dollar-cost averaging, by investing the same dollar amount at regular intervals, allows you to acquire more shares when market values are lower and fewer when prices are higher. By investing regularly in a market downturn, you can lower your average cost per share, thus enhancing your gains if your investments rebound.

But for dollar-cost averaging to be effective, you must commit to investing in both good and bad markets. So before enrolling in an automatic investment program, be sure to consider your ability and your commitment to continue to make regular investments. Bear in mind that dollar-cost averaging doesn't assure a profit, nor does it protect against loss in declining markets.

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