



Eisner TIMES Interview: Alan Patricof

Members of the Eisner TIMES editorial staff had the opportunity to interview prominent venture capital investor Alan Patricof. To find out what he had to say, read on.

E: We understand that you were one of the first venture capitalists in the technology space. How did you get started?

AP: I've been in the venture capital business since 1970, so 39 years. Before that I was managing a pension fund for a corporation. I also ran a family's money (Gottesman Central National Corporation) and for six or seven years I was the number two person there. In both situations, I managed a public market portfolio and we also ended up with several private investments. When I was managing the family's money, I invested in

a company called DataScope Corporation, which was an early stage start-up. I also started New York Magazine while I was doing that, and also made an investment in a company called LIN Broadcasting. I decided in 1970 that I enjoyed more working with private, small, start up, early-stage companies than I did with running a public market portfolio, and I recognized that I knew a number of family groups and realized that they all had public market portfolios and managed them very actively and professionally but that they also ended up with private investments because of relationships with different people and different firms. They had incidentally accumulated a series of investments in illiquid private venture companies. So I decided there was an opportunity to start a business; instead of being an investment advisor for public stocks, I would become an investment advisor for the private investments that these families made, and take that burden off of their shoulders by professionally managing the portfolio. This was the idea behind the original investment. I had nine clients who were family

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groups that I went out and obtained, and then I secured a small fund as the tenth client. That was the genesis of how I got in the business, and here we are, 39 years later.

E: What do you enjoy most about venture capital?

AP: It is very satisfying to be involved with a growth company and to be part of it, to grow with the company and to see it develop. There is a personal satisfaction and identification with those kinds of investments as opposed to buying IBM or Xerox. I still find that very exciting, which is why three years ago I started Greycroft Partners, which is really going back to where I was in 1970. I built APAX, which originally was called Alan Patricof Associates (APA) for the first 30 years and as we grew I determined we needed a name that was simpler. I decided on Alan Patricof Associates Cross-border – APAX. APAX, when I decided to phase out of active management in 2004, had 12 offices in 12 countries, employed several hundred people and had \$20 billion under management at the time (now \$35 billion). The nature of the business had changed dramatically. Previously, APAX did growth buyouts; today, APAX does mega buyouts. Mega meaning their smallest investment today is probably 100 times the size of my original fund in total.

E: What are some of the recent trends and successes that you have been seeing in the technology and media industries?

AP: Technology is always about change. What is hot today is yesterday's technology tomorrow. I still think the cell phone is a very important technology. I focus primarily on applications of technology as opposed to creating new technologies. I leave that to other people because that's a much more capital-intensive business. What I focus on now is using the internet and using the mobile phone in innovative directions and creating applications and content for that media. We do tangentially get into things like cloud computing and generally outsourcing of technology. What's happened in the technology world, as a

result of new technology, young companies can get in the business with much less capital than they used to before. The cost of everything has shrunk so much that you can do a start up in the so-called technology world for easily less than \$10 million and probably under \$5 million. You can build a company to a cash flow-positive position because you can tap into technologies that are developed by others.

E: What are some of the challenges that companies are facing in today's market and how are they dealing with them? What advice would you give an entrepreneur in the start-up world on how to get through tough times?

AP: I think the major message today to everybody is conserve your cash. Make do with whatever money you have today and assume you are not going to raise any more money for the next 12-18 months. This is easier said than done, but I think that more than ever, it puts an emphasis on a meticulous attention to detail and not being casual about anything you do, such as the limiting the number of phones you have, turning off the lights, cutting down on any excess and focusing on primarily revenue-generating activities. At the same time, you can't sacrifice keeping up technologically with the competition because people keep moving ahead. I think you have to be very sensitive to living within your own means and anticipating beforehand how you can get through this chasm we're going through, whether it's figuring out ways to use your suppliers' capital, longer terms on payables, collecting more quickly on your receivables, getting your customers to share non-recurring engineering costs or anything you can do to increase your ability to stay alive during this period of time. Using outsourcing or anything that will reduce your capital expenditures such as taking advantage of cloud computing or Linux software to make your capital more efficient will reduce your expense level. I think the challenge is more to be here when we come out of this recovery than to necessarily grow aggressively. On the other hand, if you are a company that is well-funded and has a lot of cash, this is a different kind of situation

– this is an opportune time to increase your market share, be aggressive and make acquisitions. But that’s not a luxury that most small companies have.

E: What do you see today in regards to financing opportunities for technology and media company opportunities?

AP: I always say that the venture capital business has been in pretty good shape over the past year because our companies don’t owe any money as they are financed by equity. So, we don’t have an interest burden, which is an issue for most young companies. We don’t have borrowed capital because most people won’t lend money to young companies at this stage. It’s not that we wouldn’t like to have the leverage of using borrowed capital, but it is not a luxury for most young companies. They are mostly equity-financed. There is capital around. If you have a good idea, good project and good team, there are opportunities.

E: What sectors of the technology and media industries are you excited about currently?

AP: We are making new investments all the time. We’ve made a recent investment in a company that is involved with transcoding, which is really creating a ubiquitous methodology for transmitting video to any digital, online, or consumer video because everyone has a different modality from which they receive video. This company has developed a very exciting technology which enables users to do transcoding in the cloud, which reduces their capital expenditures. We are investing in this company because it will help other companies reduce their costs and be more efficient.

We’ve invested in a company that’s doing ad traffic management for television, radio, and the internet. The company came to see us a year ago and was preparing to do the same thing it’s doing now but with a lot of hardware. We didn’t go forward with it, and they managed to come back with a new approach to the same challenge, but with software instead of hardware,

reducing their capital need from \$12 million to \$3 million. That to us is very interesting.

We also recently bought into a new content company which has created a community on the web for mothers. We are looking at a video gaming company, ad management networks and e-commerce companies, and we’re very much open to new investments. This is a good opportunity, a good time.

E: Many of our readers are in the technology and media industries. What suggestions do you have for their businesses to succeed?

AP: I think this is a good time for entrepreneurial companies. The past has shown that many very successful companies have started up during difficult times because they can get people to work for them, rent and salaries are lower and because they don’t have to defend the past position. One of the things I happen to believe very strongly in, and for which I have written a blog on *The New York Times*, I believe very strongly that for young companies today, their exit strategy is to be sold in an M&A transaction. I think the idea of an IPO is more of a dream than reality, and past results show that more than 90% of the companies in the digital media world get sold for between \$20 and \$100 million. The average for the last nine years has been \$70 million. If this is the exit strategy, then companies have to be very capital efficient and reduce their capital needs so that they are not heavily diluted. Entrepreneurs should be focused on capital efficiency, reduce their dilutions and be realistic about the exits. We’re past the days of dreaming of a \$500 million offering. The minimum public offering today in my opinion is probably a \$50 million fundraising with a market value of \$250 million. Very few people get through this hole in the tunnel. Therefore, people have to think realistically. If you are capital efficient, you can build a company and sell it at that price level and make a very good return for the entrepreneur and for the investors.

Deferring Taxes on Advance Cash Payments

Murray Solomon

“Show me the money!”

“Cash is king!”

We all know the importance of getting the cash as soon as possible, even if a company expects to provide the related products or services over a number of years. Some technology, media, and entertainment companies don't know there is a way to defer the tax related to advanced payments received in connection with many of their common transactions. GAAP accounting forces companies to recognize the revenue from advance payments over the period that the products or services are delivered. In the tax world, though, the revenue from advanced payments generally must be recognized in the year received.

Companies can make a special tax election to defer the recognition of income from advanced payments for one year. This special rule is provided by the Internal Revenue Service under their Revenue Procedure 2004-34 and allows taxpayers to basically follow the book treatment in the first year. However, any revenue deferred must be recognized for tax in the second year.

Take the following example. A licensing company enters into an agreement to license the rights to a manufacturer to use its trademarks on a new product for a period of five years. The terms of the licensing agreement are such that the manufacturer pays the licensor a non-refundable guaranteed minimum royalty payment on the signing of the contract. GAAP accounting requires the licensing company to defer the recognition of the revenue from that advanced royalty payment over the period the

license is used. Therefore, for book purposes, some amount of the advanced payment will be recognized in the first year of the contract but the remaining revenue will be recognized over the contract's remaining five years.

If the licensing company elects to use the tax accounting method provided by Revenue Procedure 2004-34, it will recognize the same amount of revenue as GAAP accounting in the first year and defer the remaining revenue to the second year notwithstanding that all the cash was received up front.

This tax accounting method can provide a one-year deferral on a significant amount of revenue and can be used for a wide variety of transactions. Some of the transactions that this accounting method is specifically allowed for include:

- Any type of service;
- The sale of goods;
- The license or lease of most intellectual property;
- The occupancy or use of property if the occupancy or use is ancillary to the provision of services (for example, advance payments for the use of rooms or other quarters in a hotel or booth space at a trade show);
- The sale, lease, or license of computer software; and
- Subscriptions, whether or not provided in a tangible or intangible format.

One thing to note is that this is a tax accounting method and, once elected and applied, it must be used for all advanced payments received.

The Success of Fantasy Sports

Steven Kreit

I have been playing in a fantasy football league for 20 years. When our league first started, our commissioner would compile all the statistics using the *New York Post*. He received dozens of phone calls—starting Sunday night and continuing through Tuesday night—requesting the other teams' line-ups, results of games and league standings. As owners of teams, we used to get all our information from newspapers. I remember one season in particular (1990) when my team was in first place, riding the scoring of both Warren Moon and Jim Kelly. Then the unthinkable happened; both players got hurt right before my league's super bowl. After getting whatever information we could gather out of the New York newspapers (which was very little), we picked up Babe Laufenberg. Babe was the back-up quarterback for the Dallas Cowboys and just happened to be starting the week we needed him. Needless to say, we lost the game and our great season went awry like a Babe Laufenberg pass.

Fantasy sports has come a long way from newspapers and numerous phone calls with the marriage of the internet and the fantasy sports participant. While it used to be a hobby for a few diehard sports enthusiasts, it is now a multi-billion dollar industry with an estimated market size of 27 million participants in the U.S. alone.

With the use of the internet, fantasy football players can access information real-time. When I first started playing and I had to prepare for the annual draft, I bought a magazine that was printed in June and used this to build a team, relying on reading magazine and newspaper coverage and watching as much pre-season football as I could. (If you have ever watched much pre-

season football, you know this is not fun.) Now I have a choice of internet sites that let me enter my league rules and will help me rank players with information up to the day I draft. During the season, I have sites that e-mail me news on players that are on my roster, players for whom I may want to trade, and players that are free to pick up for later use. My commissioner uses another site that keeps all of our league's vital information including results of our games, standings, transactions and of course prizes. And guess what: This all costs money.

Most sites charge for a season or annual subscriptions. The site we use to run the league charges us by the season for this service. (Once the football season is over, we have to re-subscribe and pay up to run a fantasy baseball league.) The site I personally use to prepare

“The biggest revenue generator for fantasy sports is advertising. The typical fantasy sports player is part of the dream demographic: male, college educated, under 40, married, in a high income bracket, and more likely to make purchases online.”

for my draft charges me annually and I can use it for football and then for fantasy hockey, basketball and baseball. Many of these sites will give you some free information, but then you need to pay for the more in depth “expert” analysis.

The biggest revenue generator for fantasy sports is advertising. The typical fantasy sports player is part of the dream demographic: male, college educated, under 40, married, in a high income bracket, and more likely to make purchases online. This has drawn big name media companies into fantasy sports including Yahoo, CBS, Walt Disney and News Corp.

Some companies, like Yahoo and ESPN, have offered more services and games for free in order to lure more traffic which will drive greater advertising revenue. This has helped both Yahoo and ESPN gain a larger market share. ESPN has been helped by being the name player in sports and having a TV market. They even have TV shows dedicated to fantasy sports and, of course, significant advertisers on those shows.

CBS has taken a different approach. They charge customers for their fantasy football services and believe that having people that are willing to pay is a lure for advertisers. They believe that having a high-end audience will create success with advertisers. The fact that they have sold out their ad inventory for past years supports their beliefs.

As fantasy sports continue to grow so will its use of technology and the revenue earned from it. Players will pay for quicker and more in-depth information. Advertisers will want to be part of it all. Professional sports leagues will be happy with all the additional interest.

And hopefully I will never have to start a Babe Laufenberg again.

P.S. And my partners will be very pleased that I can get back to work.

The Concern over Going Concern

Eric H. Altstadter

During an audit, the auditors have the responsibility of evaluating whether there is substantial doubt about a company's ability to continue as a going concern. During the recent financial reporting season, more companies had audit opinions that questioned that ability than at any time in recent memory. Although it is management's responsibility to evaluate this ability, what the auditors were highlighting was substantial doubt about this company's ability to be around in a year.

Under the current auditing standards, auditors evaluate several factors when considering whether a company has the ability to be in business following the year they are reporting on. Those factors include recurring operating losses, working capital deficiencies, loan defaults, availability of loans, loss of customers, loss of suppliers and litigation. If one or a number of those factors exist, the auditor discusses the Company's plans to continue with management. If those plans are reasonable, management and the auditor may conclude that substantial doubt does not exist. If they are not, management and the auditor can conclude that substantial doubt still exists. Management's plans can include possible disposal of assets, future contracts, projections, subsequent financings, history, and ability to cut certain expenses.

Of all the items auditors look at, one of the most difficult, and subjective, is the company's projections. This requires auditors to assess the assumptions used by management in their projections for the upcoming year. Assessing these assumptions can feel like looking in a crystal

ball. For example, if a company projects its sales will increase by 10%, and that they will be operational in a year, the auditor needs to ask management a number of questions such as:

“Why are sales going up?”

“What is different about next year?”

“What has the Company done to achieve the sales increase?”

“Are competitors projecting similar sales increases?”

“Does the Company have the cash to support the purchases needed for the sales increase?”

“Does the Company have the capacity for the additional sales?”

In today’s economic environment, the Public Company Accounting Oversight Board (“PCAOB”) and the Auditing Standards Board (“ASB”) has advised auditors to pay special attention to high risk areas and have questioned the long-term forecasting ability of companies. It is these forecasts that are reviewed by auditors in arriving at their conclusions. In the current economic climate, the evaluation of management plans has become increasingly difficult, and it’s about to get even more difficult.

The Financial Accounting Standards Board (“FASB”) has proposed new rules that will require companies to assess their going concern status beyond one year. The new rules are still being deliberated, so stay tuned. These rules will be different than the current PCAOB and ASB standards for auditors that still stand at one year. The PCAOB and ASB are considering changing those rules so that they are similar to the proposed FASB rules. The review of management’s ability to continue as a going concern has centered on its ability to meet its obligations for one year. This one year time

frame has always been a bright line and different conclusions could be reached if that period were even one day longer. The proposed rule removes this bright line and requires management to review its conclusions for an indefinite period of time which is at least, but not limited to, twelve months. The FASB feels that these changes will capture events occurring in the future that are reasonable and foreseeable. Management and auditors will be faced with reviewing assumptions and conclusions about expected events and results taking place eighteen to twenty-four months in the future in an unstable environment where recurring losses and an inability to keep cash exist.

These new rules will make the conversation between management and auditors even more contentious. Management often feels a going concern qualification in the opinion is a self fulfilling prophesy by the auditors. Auditors have argued that the qualification does not mean they believe that the company is going out of business or is insolvent. Some studies have found that going concern qualifications only existed in about half of companies that filed for bankruptcy.

According to data provided by Audit Analytics, there were nearly 3,600 going concern opinions filed for year end 2008 10-Ks, or almost 25% of public companies, representing a 9% increase from the prior year. These estimates were made towards the end of March, when just over 4,000 10-Ks had yet to be filed.

If the economy continues to deteriorate or is slower than expected to recover, that number may be even higher next year.

Royalty and Contract Compliance Inspections for Attest Clients

Peter Pirando

Audits, reviews and agreed upon procedures are all attest engagements. The common link in these attest engagements is the requirement that the practitioner be independent, and state so in the report on the engagement. However, royalty and contract compliance inspections are usually not attest engagements, but are considered consulting services. Would an independence conflict arise by providing attest services, such as a financial statement audit, and royalty or contract compliance inspection services, to the same client?

Per the American Institute of Certified Public Accountants' ("AICPA") Statement on Standards for Consulting Services, "The performance of Consulting Services for an attest client does not, in and of itself, impair independence. However, members and their firms performing attest services for a client should comply with applicable independence standards, rules and regulations issued by AICPA, the state boards of accountancy, state CPA societies, and other regulatory agencies."

The AICPA details requirements for independence and the performance of non-attest services in its Code of Professional Conduct ET Section 101-3. General requirements for a member or their firm ("member") for performing non-attest services are as follows.

1. The member should not perform management functions or make management decisions.
2. The client must agree to perform manage-

ment functions and make management decisions; designate a qualified individual, preferably from senior management, to oversee the services; evaluate the adequacy and results of the services performed; and accept responsibility for the results of the services.

3. The member should be satisfied that the client is able to meet their responsibilities and be able to make an informed judgment on the results of the member's work.
4. Where the member will be performing non-attest services for an attest client, an appropriately addressed engagement letter is required outlining the objectives of the engagement, the services to be performed, the client's acceptance of their responsibilities, the member's responsibilities and any limitations of the engagement.
5. Certain listed activities would impair the member's independence. These are exercising authority on behalf of a client; preparing source documents; having custody of the client's assets; supervising the client's employees; determining member recommendations to be implemented; reporting to the board of directors on management's behalf; serving as a client's stock transfer or escrow agent, registrar, general counsel or equivalent; and establishing or maintaining internal controls, including performing ongoing monitoring activities for a client.
6. When applicable, compliance with independence regulations of authoritative regulatory bodies such as the Securities and Exchange Commission ("SEC") and others are required where a member performs non-attest services for an attest client.

Consulting services, including royalty and contract compliance inspections, unless otherwise prohibited by the SEC, may be provided to audit clients without impairing independence. The following information is provided in SEC Release 33-8183, Strengthening the Commission's Requirements Regarding Auditor Independence (the "Release"). The Sarbanes Oxley Act (the "Act") "provides that the provision of any non-audit service, including tax services, that is not described" as a prohibited service, can be provided by the auditor without impairing the auditor's independence, "only if" the service has been pre-approved by the issuer's audit committee. The nine categories of prohibited non-audit services included in the Act are:

- Bookkeeping or other services related to the accounting records or financial statements of the audit client;
- Financial information systems design and implementation;
- Appraisal or valuation services, fairness opinions, or contribution-in-kind reports;
- Actuarial services;
- Internal audit outsourcing services;
- Management functions or human resources;
- Broker or dealer, investment adviser, or investment banking services;
- Legal services and expert services unrelated to the audit; and
- Any other service that the Board determines, by regulation, is impermissible.

"The Commission's principles of independence with respect to services provided by auditors are largely predicated on three basic principles, violations of which would impair the

auditor's independence: (1) an auditor cannot function in the role of management, (2) an auditor cannot audit his or her own work, and (3) an auditor cannot serve in an advocacy role for his or her client."

Additionally, also as stated in the Release, the SEC does specifically discuss forensic and fact-finding work as permissible. The Release describes this work as "performing procedures that are consistent with, but more detailed or more comprehensive than, those required by GAAS." However, were litigation to develop, the accountant would not be able to provide additional services. Still, the accountant's independence would not be impaired if the accountant provided factual accounts or testimony, or explained positions taken or conclusions reached.

PCAOB independence rules, which generally follow those of the SEC, specifically require audit firms to be independent in fact and appearance, to describe to an audit committee any relationships that may bear on their independence, prohibit an auditor from accepting contingent fees for any service provided to the client, and includes certain restrictions on tax services. However, consulting services are not otherwise prohibited.

Contingent fees are defined by the PCAOB as "any fee established for the sale of a product or the performance of any service pursuant to an arrangement in which no fee will be charged unless a specified finding or result is attained, or in which the amount of the fee is otherwise dependent upon the finding or result of such product or service."

The New York State Society of Certified Public Accountants' independence policies are also consistent with the preceding discussion. New York State rules also prohibit contingent fees, but do not prohibit consulting services for attest clients.

Broadway Fun Facts *Compiled by Jennifer Morel*

Top 10 movies adapted from Broadway shows

The Philadelphia Story (1940)
Guys and Dolls (1955)
The King and I (1956)
West Side Story (1961)
My Fair Lady (1964)
The Sound of Music (1965)
Grease (1978)
Chicago (2002)
Rent (2005)
Mamma Mia (2008)

Top 10 Broadway shows adapted from movies

The Lion King (1997)
Beauty and the Beast (1994)
Legally Blonde (2007)
The Little Mermaid (2007)
Shrek (2008)
High School Musical (2007)
Marry Poppins (2006)
How the Grinch Stole Christmas (2008)
White Christmas (2008)
Footloose (1998)

From film to Broadway to film!

The Producers is a 1968 comedy film written and directed by Mel Brooks. In 2001, Brooks adapted the film into a Broadway musical of the same name (The Producers). In 2005, a film, based in turn on that musical, was released.

Hairspray – The 2007 film is an adaptation of the 2002 Broadway musical of the same name, and loosely based on John Waters' 1988 comedy film of the same name.

Most Tony Award winners

- Play production that has won the most Tony Awards: Tom Stoppard's *The Coast of Utopia* (2007) – 7
- Musical production that has won the most Tony Awards: *The Producers*, the new Mel Brooks musical (2001) – 12
- Theatre that housed the most Tony-winning Best Plays and Best Musicals: Richard Rodgers Theatre – 10

Tony and Oscar

Tony Award-winning Best Plays and Best Musicals that were turned into Academy Award-winning Best Pictures include:

- *My Fair Lady* (Tony, 1957; Oscar, 1964)
- *The Sound of Music* (Tony 1960; Oscar 1965)
- *A Man for All Seasons* (Tony, 1962; Oscar, 1966)
- *Amadeus* (Tony, 1981; Oscar, 1984).

What a bargain!

Tickets to the first Tony Awards ceremony in 1947 cost \$7.00 each. Tickets for the 2009 Tony Awards were \$700.

Eisner was founded in 1963. That year, at the 17th Annual Tony Awards, the winners for Best Musical and Best Play were:

Musical – *A Funny Thing Happened on the Way to the Forum*

Play – *Who's Afraid of Virginia Woolf?*

Three longest running musicals of all time

The Phantom of the Opera
(1988 – present), 8,891 performances

Les Misérables (1987 – 2003),
6,680 performances

Cats (1982 – 2000), 6,485 performances

Broadway shows about accountants

The Producers:

Matthew Broderick starred in the original Broadway cast, playing timid accountant Leo Bloom.

Broadway shows and sports

The curse of the Bambino!!

The curse was said to have begun after the Boston Red Sox sold Babe Ruth, The Bambino, to the New York Yankees in the off-season of 1919-1920. The curse was a superstition referred to as the reason why the Red Sox failed to win a World Series during 86 years, from 1918 – 2004. After the purchase of Ruth, the Yankees became one of the most successful franchises in American sports history. It is said that the Red Sox owner, Harry Frazee, who was also a theatrical producer, sold Ruth to finance the production of his Broadway musical, No, No Nanette. Ruth was sold for \$125,000 in cash and \$75,000 in notes payable at a 6 percent interest rate. Frazee also borrowed \$300,000, with the mortgage on Fenway Park as collateral.



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