



AICPA/UNC Kenan-Flagler

Business and Industry Economic Outlook Survey 1st Quarter 2011



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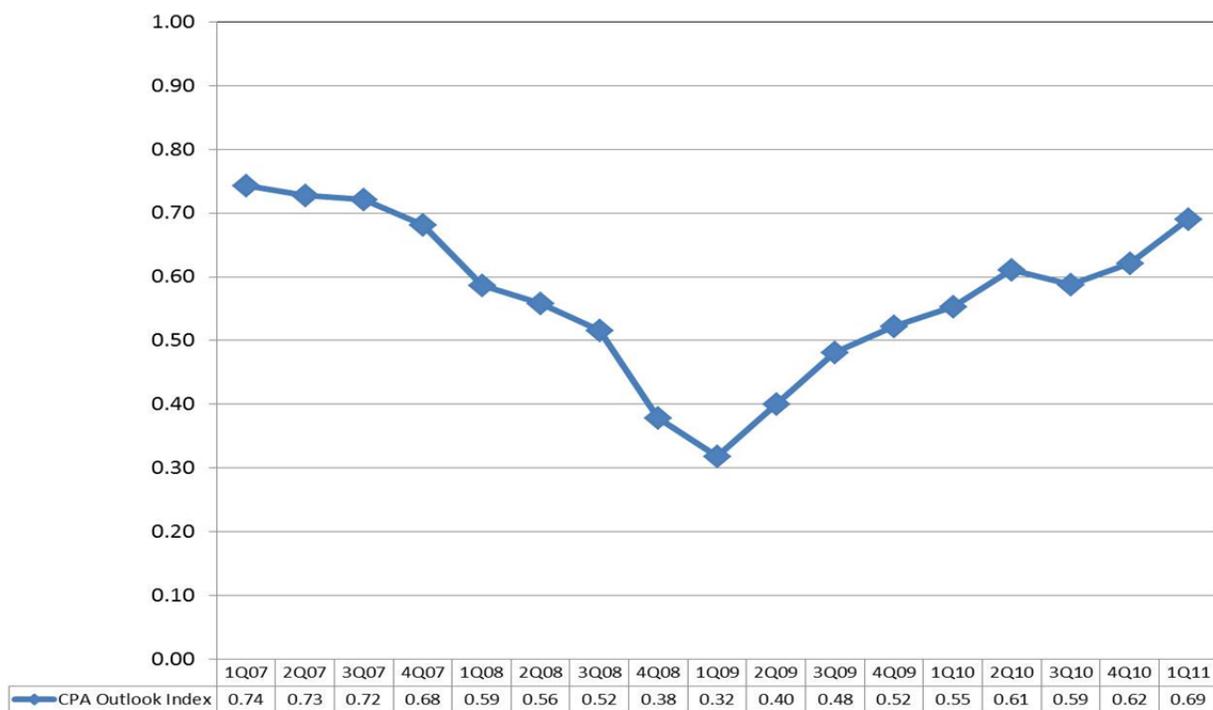
UNC
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Introducing the CPA Outlook Index

This quarter the AICPA/UNC Kenan-Flagler Economic Outlook Survey introduces a new index – the CPA Outlook Index (CPAOI). The CPAOI is a broad-based composite index that captures the expectations of our members and their plans for a breadth of indicators of economic activity. It is a composite of nine survey measures at equal weights (see CPAOI inset for description).

The CPA Outlook Index (CPAOI) increased by .07 this quarter to reach .69, its highest level since the 3rd quarter of 2007. A quarter of that improvement (26%) is attributable to the increase in optimism about the US economy which had lagged the improvement in organizational optimism which had occurred during 2010. Also contributing notably to this quarter's improvement were expectations for revenue and for training and development spending.

CPAOI Outlook Index -- ↑ .07



CPAOI - Component Indicators

Component	4Q10	1Q11	ΔQ to Q
US Economic Optimism	.49	.65	↑ .16
Organization Optimism	.67	.70	↑ .03
Expansion Plans	.71	.77	↑ .07
Revenue	.68	.77	↑ .09
Profits	.63	.69	↑ .06
Employment	.58	.63	↑ .05
IT Spending	.67	.70	↑ .03
Other Capital Spending	.62	.66	↑ .04
Training & Development	.56	.64	↑ .08

The CPA Outlook Index

This quarter the AICPA/UNC Kenan-Flagler Economic Outlook Survey introduces a new index – the CPA Outlook Index (CPAOI). The CPAOI is a robust measure of sentiment about the US economy that is supported by the unique insight and knowledge that CEOs, CFOs, Controllers, and other CPA executives have about the prospects for their own organizations, their expectations for revenues and profits, and their plans for spending and employment.

The CPAOI is a broad-based composite index that captures the expectations of our members and their plans for a breadth of indicators of economic activity. It is a composite of the following nine measures at equal weights:

- **US Economy Optimism** - Respondent optimism about the US economy.
- **Organization Optimism** - Respondent optimism about prospects for their own organization.
- **Business Expansion** - Respondent expectations of whether their business will expand over the next 12 months.
- **Revenues** - Expectations for revenue over the next 12 months.
- **Profits** - Expectations for profits over the next 12 months.
- **Employment** - Expectations for headcount over the next 12 months.
- **IT Spending** - Plans for IT spending over the next 12 months.
- **Other Capital Spending** - Plans for capital spending over the next 12 months.
- **Training & Development** - Plans for spending on employee training and development over the next 12 months.

Each individual component indicator is calculated by taking the percentage of respondents who indicated that their opinion or expectation for the metric is positive or increasing, and adding to that half of the percentage of respondents indicating a neutral or no-change response. A reading above .5 indicates a generally positive outlook with increasing activity. A reading below .5 indicates a generally negative outlook with decreasing activity.

As an example, if 60 percent of respondents indicate an optimistic or very optimistic view, and 20 percent express a neutral view, the calculation of the component indicator would be .70 [$60\% + .5 \times 20\%$].

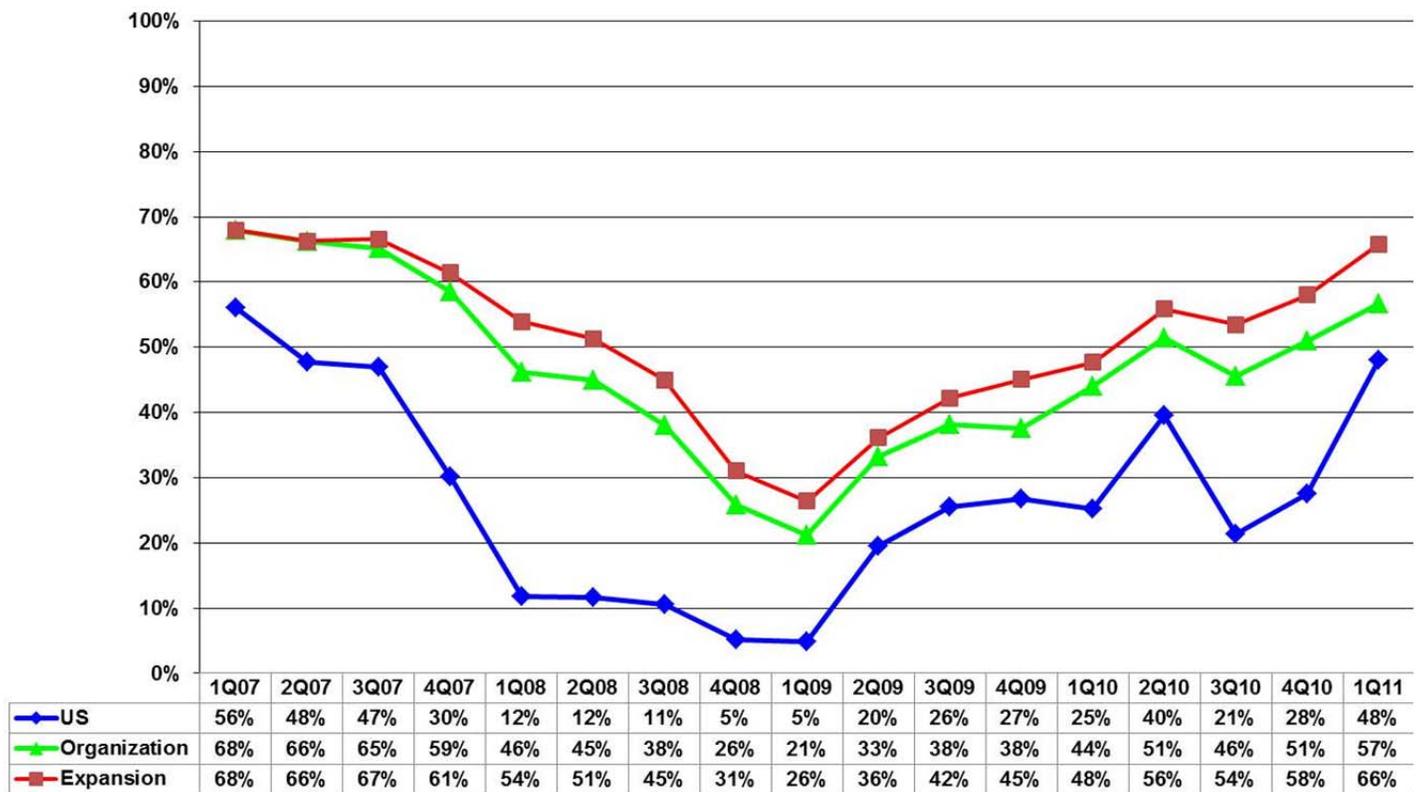
Outlook for the US Economy and Organizations

Inflation concerns shadow otherwise optimistic picture

This quarter's 20% increase in optimism for the US economy was the sharpest upturn ever seen on the survey. It was accompanied by an 11% decrease in pessimism with less than a quarter of respondents (18%) expressing a pessimistic outlook for the US economy. Optimism was driven primarily by signs of improvement in broad based economic indicators, increased customer spending and an improving outlook on employment. Pessimists were most likely to cite continuing unemployment, housing and growing government debt and deficits as reasons for their pessimism.

Optimism for organizations continued to lead optimism for the US economy as a whole with 57% of the CPA decision-makers saying that they were optimistic about the outlooks for their own organizations. This is the highest point since 4Q07. This outlook was backed by expectations of expansion with 66% of respondents expecting their organizations to expand in the next 12 months and only 13% expecting to contract.

Outlook for the US Economy, Organizations & Expansion



One hitch in the otherwise optimistic economic picture was a sharp increase in concern about inflation. Over half (55%) of all respondents are now concerned about the impact of inflation on their organizations in the next 6 months. This is up from 34% last quarter. Deflation fears have all but disappeared with only 5% expressing concern. The primary drivers of inflation concerns are raw material costs and interest rates. Less than half (45%) of respondents expect to be able to pass all or some of the increased costs on to their customers.

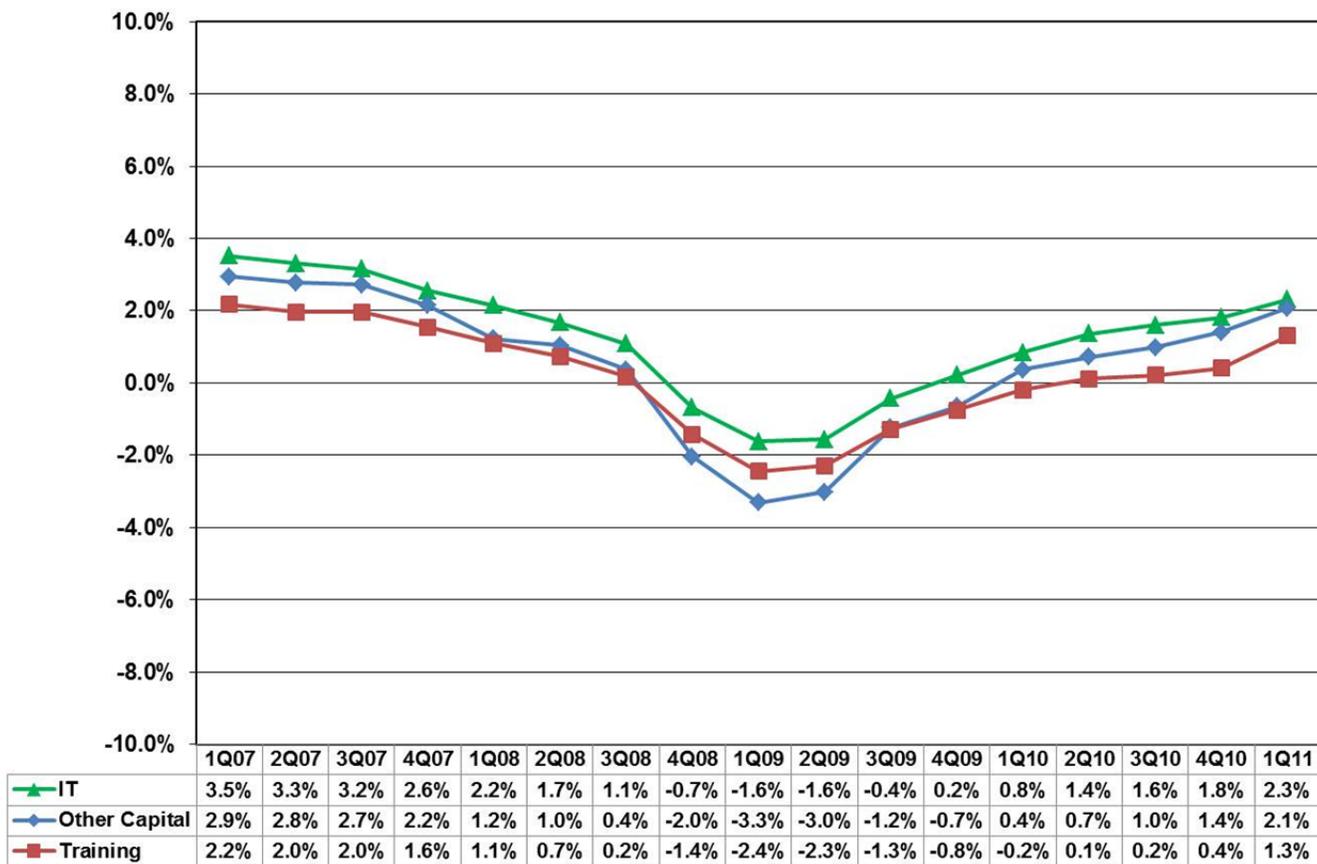
Key Performance Indicators

Staffing and spending increases support revenue and profit increases

CPA's optimism for their own organizations is likely driven by improved expectations for revenue and profit growth. Respondents expect revenue to grow an average of 3.7% and profits to grow 2.9% in the next 12 months. That growth will be accompanied by a smaller, but still positive, amount of growth in employment with organizations expecting staffing to increase by 1.5% up from just 0.6% last quarter. While 14% of respondents expect staffing to decrease, this is the smallest percentage to expect decreases since 3Q07.

Respondents concerns about inflation are accompanied by expectations of paying increased prices with respondents expecting input prices to increase an average of 2.6% in the next 12 months. However they do not expect to be able to pass all of that increase on as they expect prices charges to increase an average of 1.4%. The good news for employees is that salaries and benefits are expected to increase by 2%, the largest increase since 2008. Healthcare costs are expected to increase 6.7% over the next year.

Spending for IT, Other Capital and Training



CPA decision-makers also expect their organizations to spend more in the next 12 months. IT spending is expected to increase an average of 2.3% while other capital spending is expected to increase 2.1% up from a 1.4% expected increase last quarter. The largest improvement was seen in spending on training and staff development. While spending is still only expected to increase slightly, the outlook has improved from an expected 0.4% increase last quarter to a 1.3% decrease this quarter. Even more significant is the improvement from the -0.2% decrease that was expected in 1Q10 and an even more impressive improvement from the -2.4%

decrease that was expected in 1Q09. Plans for marketing and R&D expenditures are also up slightly (1.6% and 1.5% respectively) but still lag behind expectations for IT and other capital spending.

Hiring Plans

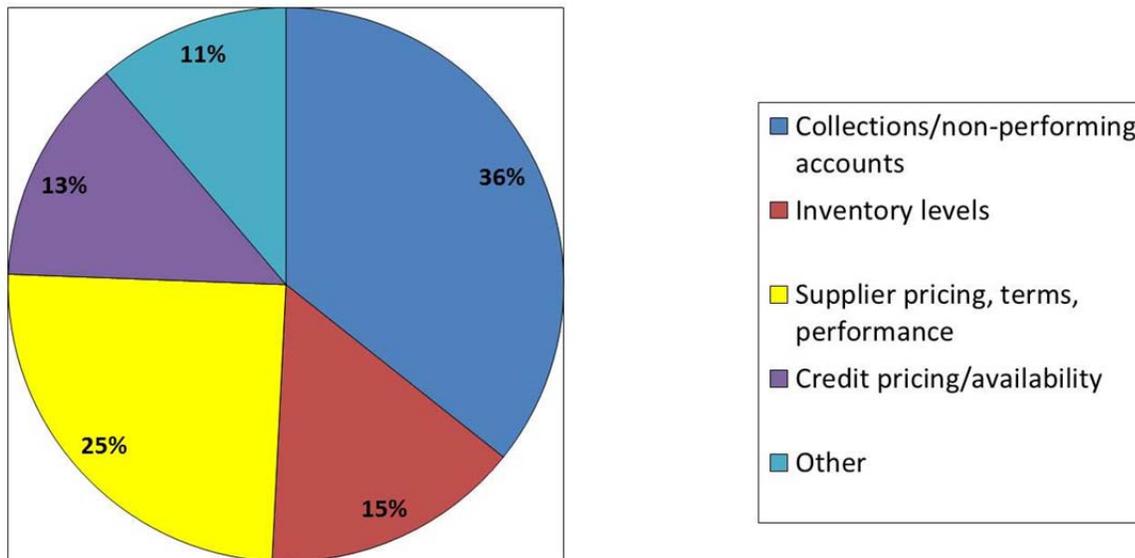
Hiring Plans show a glimmer of improvement this quarter

Thirteen percent of respondents now indicate that they have current plans to hire. While this is still a small number it is up from 10% last quarter and 7% over 1Q10. Another 19% feel they have too few employees but are still hesitant to hire. Only 11% currently have excess employees with the majority, 55%, saying that they have the right number of employees. Despite these improvements it will still take some time for employment to return to pre-recession levels. While 38% of respondents never saw a decline or have already returned to pre-recession levels, 28% do not expect to get there in the foreseeable future. Only 7% expect to reach that level in the next 12 months and 23% expect it will happen in 12 to 24 months.

Liquidity

Cash positions are generally good but inadequate sales volumes pose the largest risk to cash flows

Respondents to the survey generally have enough cash but less than a third (30%) have more than they currently need and only 19% are currently reluctant to deploy that cash. Forty-six percent feel their cash position is about right and 12% expect to raise capital and another 12% need to raise capital but expect to have problems doing so. Twenty-nine percent have seen their cash position improve over the past 6 months while an almost equal number, 25%, have seen it deteriorate. Collections/non-performing accounts represent the largest working capital management challenge.



Top Challenges

Customer demand, employee healthcare costs and regulatory requirements remain the top 3 challenges

For the 4th consecutive quarter customer demand, employee healthcare costs and regulatory requirements topped the list of challenges facing organizations. A new addition to the list, economic and political instability debuted in the fourth spot.

1Q10	2Q10	3Q10	4Q10	1Q11
Customer Demand				
Employee health care costs				
Access to capital/ cost of capital	Regulatory requirements	Regulatory requirements	Regulatory requirements	Regulatory requirements
Regulatory requirements	Access to capital/ cost of capital	Access to capital/ cost of capital	Access to capital/ cost of capital	Political and economic Instability
Collecting receivables	Materials & supplies costs	Collecting receivables	Materials & supplies costs	Materials & supplies costs
Liquidity	Collecting receivables	Materials & supplies costs	Availability of skilled personnel	Access to capital/ cost of capital
Materials & supplies costs	Employee & benefits costs	Availability of skilled personnel	Collecting receivables	Availability of skilled personnel
Avoiding layoffs	Liquidity	Liquidity	Liquidity	Collecting receivables
Employee & benefits costs	Availability of skilled personnel	Employee & benefits costs	Employee & benefits costs	Commodity costs
Availability of skilled personnel	Staff Turnover	Staff Turnover	Commodity Costs	Liquidity

Industry, Region and Business Size Outlook

Technology industry respondents remain the most optimistic and have the greatest expectation for hiring

Optimism increased across most industries this quarter. Respondents from the Technology industry are once again the most optimistic while respondents from Construction and Healthcare providers are the least optimistic. Respondents from the Retail and Wholesale trade industries showed the largest increase in optimism. The Technology industry also expects to do the most hiring with an average expected growth in the number of employees of 4.4%. The least optimistic industries of Construction and Healthcare Providers also expect to do the least amount of hiring at 0.4% and 0.3% respectively.

Optimism also increased across all regions of the country. Respondents from the Midwest were the most optimistic about their own organizations while respondents from the South were the least optimistic. Seventy-seven percent of companies with revenues above \$1 billion are expecting expansion while 61% of the smallest companies (revenues below \$10 million) are.

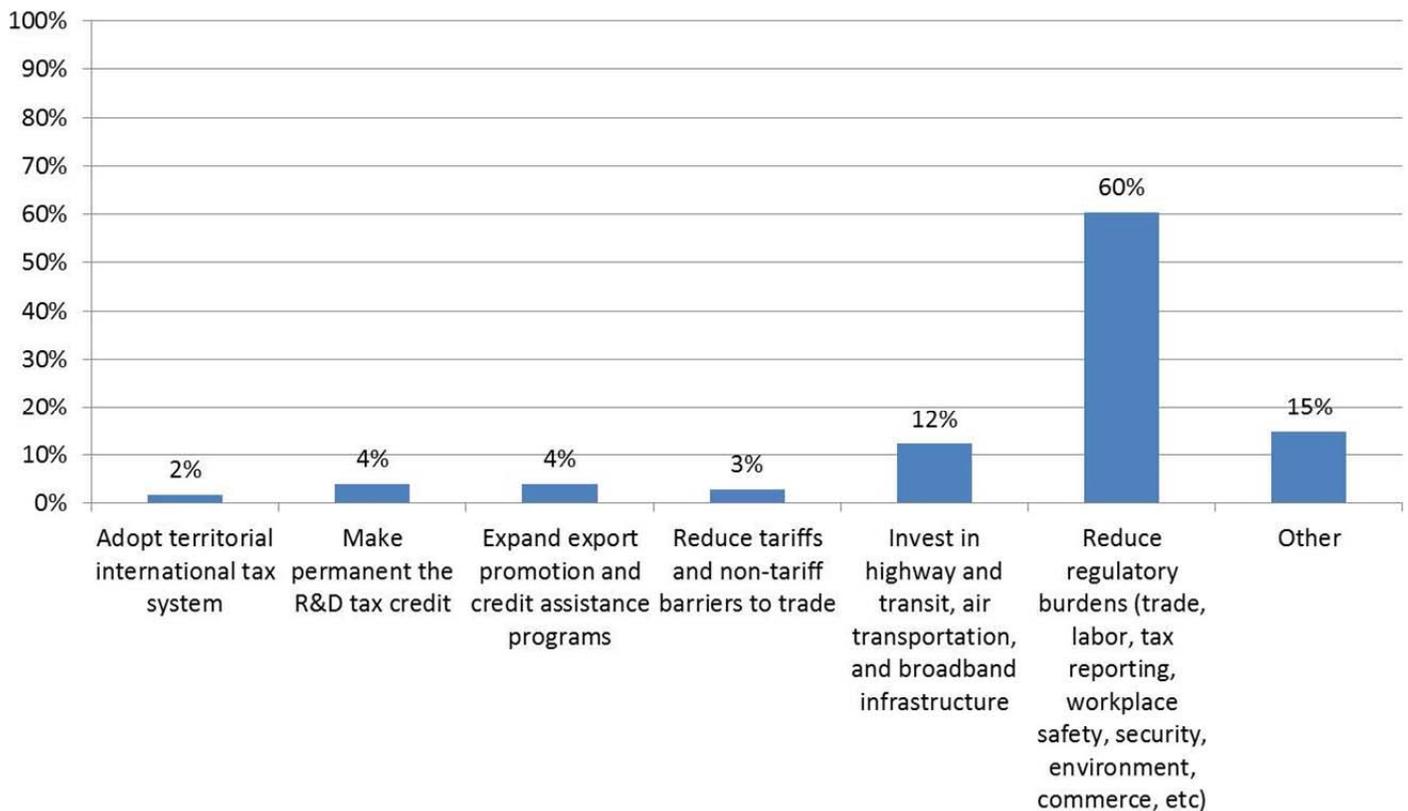
Small Business Jobs Act and Tax Reform

Respondents prefer regulatory reform over other programs to help with job creation

This quarter's survey within a survey focused on the Small Business Jobs Act and other tax reform proposals. Forty-seven percent of respondents expect to take at least partial advantage of the provision of the Small Business Jobs Act that would permit them to expense up to \$500K in equipment. Another 13% expect to exceed the threshold for the deduction while 27% don't plan to purchase eligible equipment.

When asked about recommendations that would provide the largest impact on their business's ability to create jobs respondents overwhelmingly chose reduction of regulatory burdens.

Policy with Largest Impact on Ability to Create Jobs



When asked about their preferences for offsetting reductions in corporate taxes, respondents were most in favor of reduced spending only with 51% choosing that option. The next most favored options at 11% and 10% respectively were taxing overseas income generated by certain transfer pricing maneuvers and eliminating tax breaks for oil & gas production. When asked to choose their least favorite option respondents showed more diversity of opinion with 23% indicating limiting of the mortgage deduction

was least favored followed by enacting a carbon tax (16%), raising the earnings cap on Social Security (13%) and raising gasoline taxes (12%). Countering the majority who chose reducing spending only as their favorite option, 12% of respondents choose this as their least favorite option.

Survey Background

The survey was conducted of AICPA Business & Industry members between February 9, 2011 and February 24, 2011 and had 1168 qualified respondents. Fifty-two percent of respondents were CFOs, 16% were Controllers, 13% were CEOs or Presidents, 7% were VPs, 5% were CAOs, CAEs, CIOs or COOs and the remainder were Directors or Other. Seventy-one percent of respondents came from US privately owned entities, 11% from US public companies, 12% from government, education and not-for-profits and 5% from foreign owned companies. Ten percent came from organizations with annual revenues of 1 billion or more, 19% from organizations with \$100 million to under \$1 billion in annual revenues, 47% from organizations with \$10 million to \$100 million and 24% from organizations with under \$10 million in revenues.