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Prepare for major changes to federal rules on employee pay and benefits

Accounts receivable management
How manufacturers can bridge the cash gap

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Does your business have a valid buy-sell agreement in place?

Owners of manufacturing and distribution companies are often so focused on the here and now that planning for future catastrophes may fall through the cracks, especially if the owners are young and healthy. But operating without a valid buy-sell agreement is like driving without car insurance. Failure to execute an agreement or to update an old buy-sell for ownership changes can cause financial distress and even tear a company apart if tragedy strikes.

Cover all the bases

Private companies enter into buy-sell agreements to address voluntary and involuntary changes in ownership that might occur in the future. Examples of events that could trigger a buy-sell agreement include:

Death of an owner. When an owner dies, a buy-sell dictates how the deceased owner's interest will be handled. Will heirs inherit the shares and have a say-so in future business decisions? Or will the company (or the remaining shareholders) buy the interest? If so, will the buyout be funded by life insurance?

Owner departures. When an owner retires, leaves to pursue other interests or becomes disabled, the buy-sell should spell out the departure terms, including the owner's postdeparture role in decision-making, buyout terms and whether the departing owner's interest will transfer to a designated heir if he or she dies.

Resolving valuation issues when the agreement is drafted can help ensure that all parties are treated equitably when the unexpected strikes or disagreement mounts.

Irreconcilable differences among owners. When owners fundamentally disagree with a company's direction and want to leave the business, the agreement states how disputes will be resolved and what rights dissidents have.

It's a good idea to iron out details when owner relations are amicable. Lawsuits are common when owners wait until problems have started to unfold to discuss issues related to ownership changes.

Address valuation issues

When a "triggering event" occurs, the parties are usually at odds over the value of the business. Resolving valuation issues when the agreement is drafted can help ensure that all parties are treated equitably when the unexpected strikes or disagreement mounts.

Some owners opt to have the business valued when they're drafting the buy-sell agreement. Then, they use that static value to buy out a departing owner's interest whenever the buy-sell is triggered. But fair market value can change as market conditions and the business evolve, and a valuation performed many years ago may become stale.

Alternatively, owners may decide to have the business valued annually, so fair market value is readily available and there aren't any surprises when the buy-sell is triggered. Or they may prescribe valuation protocol to follow when the agreement is triggered, including how "value" is defined, who will value the business, whether valuation discounts will apply, who will pay appraisal fees and how the buyout will proceed.

Weigh the options

The two most common types of buyout structures are cross-purchase agreements and redemption agreements. Under the former, if an owner leaves the business (voluntarily or not), the remaining owners have the right to buy the departing owner's interest either in one lump sum or in installments, depending on how the buy-sell is written. In case of death or disability, cross-purchase agreements also may be funded by insurance.

In a redemption agreement, the company itself, not the individual owners, buys out the departing owner's interest. The value is effectively transferred to the remaining owners by reducing the number of outstanding shares. Life insurance policies (in which the company is named as the beneficiary) may be used to fund redemption agreements, too.

Iron out the details

In any buy-sell agreement, the keys are to be clear and comprehensive. The more details that are put in place today, the easier it will be for owners to resolve issues when the unexpected strikes, disputes arise or an owner simply decides to call it quits. ■

Avoiding family business transfer pitfalls

Many manufacturing and distribution companies are family owned. But passing the torch from one generation to the next isn't always the best decision. Today's owners should realistically assess whether their sons and daughters have what it takes to run a successful operation tomorrow.

It's tough for owners to treat their loved ones as employees first, but that's how to objectively evaluate their abilities. Promoting a relative who's not up to the task typically backfires. It could cause reduced morale among workers who aren't related to the owners and eventually lead to the departure of key employees.

Owners can draft ownership transfer agreements that list benchmarks for a potential successor to achieve before acquiring an interest in the company. For example, a potential successor could be given the goal of achieving a certain growth percentage in his or her division or hitting predetermined sales targets over the next 12 months. Whatever the goal, the agreement should be specific.

Also meet with potential successors to find out whether they even *want* to take over. Parents sometimes find out that their dreams of passing on a legacy don't align with their children's future plans, forcing them to find an alternate exit strategy — sometimes at the last minute.

Prepare for major changes to federal rules on employee pay and benefits

One of your most dreaded tasks is probably managing human resources (HR). The rules are ever-changing and becoming increasingly complex. Here are two major developments related to the federal rules governing employee pay and benefits that employers should be ready for this year.

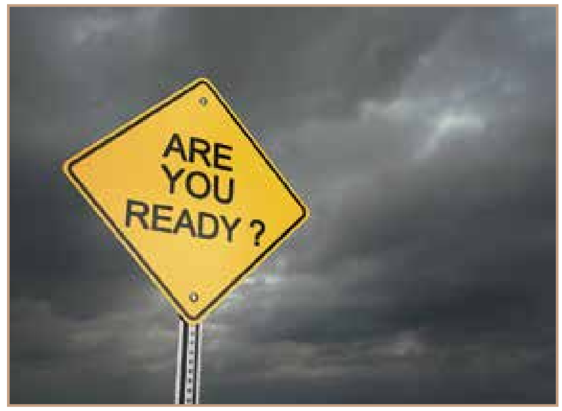
Complying with new ACA requirements

The Affordable Care Act (ACA) requires applicable large employers (ALEs) to offer their full-time employees and their dependents minimum essential coverage that is affordable and provides minimum value. An ALE is defined as one having 50 or more full-time and full-time equivalent employees.

The ACA requirements are set to gradually unfold over several years to give companies time to ramp up their health care coverage. New reporting requirements that should be on an ALE's radar for 2016 include two new forms:

Form 1095-C, "Employer-Provided Health Insurance Offer and Coverage." Employers must send copies of this form (similar to Form W-2, "Wage and Tax Statement") to both the IRS and full-time employees. It reports the following information, for each full-time employee, broken down by month:

- Details about the type of coverage offered to each employee,
- Whether the employee was enrolled in the plan,
- The employee's share of the lowest-cost self-only minimum value coverage, and
- Whether the affordability safe harbor or other transition relief applies.



Form 1094-C, "Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns." This form is similar to a Form W-3, "Transmittal of Wage and Tax Statements." To complete an authoritative transmittal on Form 1094-C, employers must report:

- Whether coverage was offered to at least 70% of the organization's full-time employees in 2015 (or 95% of its full-time employees in 2016 and beyond),
- The total number of 1095-C forms the organization issued,
- The number of full-time employees and total number of employees by month,
- Information about members of the aggregated employer group (if applicable), and
- Whether the organization qualifies for transition relief.

These forms are due to the IRS by February 29, 2016 (or March 31, 2016, if filing electronically) for the 2015 tax year. Employee statements must be furnished no later than February 1, 2016.

A potential pitfall may occur when employers assume that someone else is handling their ACA compliance. But the responsibility ultimately lies with the *company*, not its audit firm, benefits provider, insurer, payroll company or tax preparer. If you want outside assistance, you need to *specifically* ask your advisor for it.

Paying additional overtime

The U.S. Department of Labor (DOL) sets federal labor guidelines that apply to most public and private sector employees. On June 30, 2015, the DOL proposed changes to the overtime rules under the Fair Labor Standards Act (FLSA) that would make an estimated 5 million more workers eligible for overtime pay.

When employees work more than 40 hours per week, they're entitled to overtime pay equal to 1.5 times the usual pay rate. Under the current rules, white-collar employees are exempt from overtime pay if they meet these three requirements: First, they must be paid a predetermined and fixed salary. Second, they must be paid more than a specific salary threshold, currently $455 a week ($23,660 for a full-year worker). And, third, they must primarily perform executive, administrative, or professional duties, as defined in DOL regulations.

Under the DOL's proposed revisions, the salary threshold for the white collar exemption would increase to approximately $970 a week ($50,440 for a full-year worker) and would be adjusted annually.

When the comment period ended on September 4, the DOL had received nearly 150,000 responses from concerned stakeholders. The DOL could take several months to issue a final rule, which may include one-time or gradual increases in the proposed salary thresholds. Or the proposal could be derailed indefinitely, causing significant uncertainty for HR professionals and employees.

Seeking outside help

To simplify matters, some smaller manufacturers and distributors opt to outsource all of their HR functions. Doing so allows management to focus on what they do best — making quality products and delivering them to customers. ■

Accounts receivable management

How manufacturers can bridge the cash gap

Accounts receivable is often one of the biggest assets on a manufacturer's balance sheet. But the faster you're able to convert receivables to cash, the sooner you're able to pay suppliers, employees and lenders — and the less likely you'll be to draw on your line of credit to make up for working capital shortfalls.

Unfortunately, many of your customers may have gotten into the habit of extending payment terms during the recession. Now that the market has picked up, it's time to retrain your customers to pay on time. The simple concept of the "cash gap" shows you the importance of minimizing accounts receivable.

Cash in vs. cash out

Calculating your company's cash gap is simple: Add the average days in inventory to the average collection period for accounts receivable and subtract the average payment period for accounts payable.

90-day cash gap). At higher interest rates, the incremental interest costs related to the cash gap are even more pronounced.

Eyes on collections

There are few options to reduce the cash gap. You can cut back on inventory in your warehouse, but doing so may lead to shortages and eliminate bulk discounts. You can delay paying suppliers at the risk of losing early-bird discounts and receiving less favorable credit terms.

For example, suppose ABC Co. stocks about 50 days' inventory in its warehouse, collects its receivables in about 60 days and pays off its suppliers within 20 days. ABC's cash gap would be 90 days (50 days in inventory + 60 days in receivables - 20 days in payables = 90 days).

Incremental interest costs

The cash gap reflects the timing difference between when companies order materials and pay suppliers and when they receive payment from their customers. This difference is frequently financed by a company's line of credit. When funded by bank financing, the cash gap incurs incremental interest costs that can be easily quantified.

Getting back to our fictitious manufacturer, suppose ABC achieves a 60% gross margin on its $10 million in annual revenues, which equates to a $4 million annual cost of sales. ABC's 90-day cash gap means that the company must front — and presumably finance — 90 days' worth of its annual cost of sales, or roughly $986,000 [($4 million cost of sales ÷ 365 days) × 90 days].

If we assume a 5% interest rate on its line of credit — and ignore taxes — ABC's cash gap costs the company about $49,000 each year in interest expense. For every day it shaves off its cash gap, ABC will improve its pretax profits by nearly $550 ($49,000 of interest divided by its

So speeding up collections is often the most effective and simplest way to lower the cash gap. Five ways to encourage customers to pay invoices include:

1. Performing credit checks on prospective customers,
2. Flagging new customers to ensure initial invoices are paid on time,
3. Sending out past-due reminder letters or email messages and following up with phone calls,
4. Offering "early-bird" discounts to customers that pay within 10 or 20 days, and
5. Hiring dedicated, experienced collection personnel.

Manufacturers also should evaluate invoicing procedures to minimize the days in receivables. Poor communication among billing, sales and production staff can cause invoicing delays.

A low-risk approach

But there's no good reason to allow receivables to build up on your balance sheet — and no risk to expediting collections. So if you're looking for a quick and simple way to shrink the cash gap, always start with receivables. ■

Secure equipment disposal

Disposal of IT assets warrants the same attention as acquisition

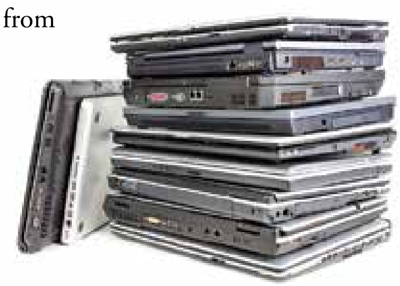
Manufacturers and distributors spend significant resources choosing the right information technology (IT) equipment to invest in — and securing devices throughout their useful lives with firewalls, passwords, encryption, antivirus software and dedicated staff. But security sometimes falls by the wayside when assets are retired. Ongoing attention to security is a priority, because IT equipment typically houses a company's most valuable intellectual property.

Security breaches

Just because data *appears* to have been deleted from a device's hard drive doesn't mean it's gone. Some data may be recoverable — even if you smash a device with a sledgehammer — and recovered data can come back to haunt you if it winds up in the wrong hands.

For example, Company A (a fictitious manufacturer) returned two copiers to its equipment leasing company. Neither party erased the devices' internal hard drives, which stored everything that Company A had copied or scanned over the term of its lease. When the leasing company subsequently sold the copiers to a competitor, the buyer also obtained Company A's financial data, customer lists and employee records.

Security incidents also can arise when a company resells, recycles or donates its old IT equipment without properly erasing the hard drives. In other breaches, thieves steal assets from dumpsters or unlocked storage sites before management wipes the hard drives. The result? Large volumes of confidential data are left unprotected and vulnerable to theft and fraud.



Bulletproof disposal protocols

Asset-intensive companies need formal company-wide IT disposal policies to ensure reliable data destruction. Here's some guidance to consider when drafting an IT disposal policy:

Rewrite multiple times. Companies can't just delete data once, because it can still be reconstructed from the device by an IT professional. Many Fortune 500 companies and the federal government follow the Department of Defense protocol, which requires data to be rewritten at least three times.

Consider outsourcing. Companies often turn to outside disposal vendors to ensure safe disposal and factor disposal fees into the total cost of equipment ownership. Equipment retailers, manufacturers and leasing companies also may provide these services upon request.

If you decide to outsource disposal, choose your vendors wisely. The cheapest vendor might skip steps, such as performing background checks on employees and their subcontractors, offering risk indemnification, tracking assets during the disposal process and ensuring that assets are disposed of in an environmentally responsible manner.

Act quickly. Dispose of outdated equipment as soon as you upgrade. Doing so reduces the risk of theft and increases the price you'll receive at resale.

As IT assets near the ends of their life spans, consider whether the devices can be repurposed. Sometimes equipment can be reused internally to temporarily save the cost (and hassle) of secure disposal. ■

Hertzbach & Company, P.A.

Helping manufacturers produce successful businesses for over 65 years.

Hertzbach & Company, P.A. has more than 65 years of experience in helping manufacturing and distribution firms achieve their financial goals. We can guide you in analyzing and managing the unique risks in this cyclical industry. Our clients tell us that our consulting services help them improve the efficiency, profitability and longevity of their businesses. Manufacturers have unique needs in the business world. Today's volatile economic conditions make operating a manufacturing company especially challenging, requiring management's constant attention to every aspect of the business. As a manufacturer or distributor of goods, your profitability is subject to the ups and downs of the economy.

Government regulations, collective bargaining and liability issues seem to be the only sure things in your industry. To have any chance of success you need excellent management, marketing, planning, analysis and internal controls. More than ever, managers in the manufacturing industry must keep a watchful eye on areas such as profit centers, tax considerations, and state and local regulations.

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