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Strategic alliances: Leverage strengths, minimize weaknesses

The importance of using qualified employee benefit plan auditors

The ins and outs of using accountable plans to save taxes

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6 simple steps to shrink your outstanding receivables

Your sales team closes a custom order for a new customer. Then the production crew works diligently to meet the order's two-week deadline. The final product meets the customer's specs and ships on time. But what's missing?

Everyone was so preoccupied with completing the sale that no one bothered to check the customer's credit or collect a down payment. What's more, a billing clerk had to chase down the sales rep and plant manager to get all the necessary information to accurately complete the invoice — which was mailed a month after delivery. Now, everyone's attention has returned to making the next sale or batch of product, leaving no one to follow up on payment.

If this sounds familiar, you're not alone. Scenarios like this play out in factories from coast to coast, costing them all big bucks in the long run.

When cash flow doesn't keep pace with work flow, manufacturers need to take a hard look at their billing practices to ensure no jobs fall through the cracks. Here are six ways to strengthen your collection process:

1. Make collections everyone's job. Poor collections are often blamed on office personnel, but almost every employee has a role in the company getting paid. Salespeople are your front line: They must obtain accurate billing information from customers (phone numbers, email addresses and names of payables personnel), as well as request approval to perform credit checks. They also need to negotiate contract terms — such as early-bird discounts, late payment penalties and down payments on custom orders — that will help get money in the door faster. The owner or CFO should approve all new customers and terms before the accounting department sets them up in the system.

In addition, factory workers need to code jobs properly and notify the billing department when orders ship. And office personnel must promptly submit invoices and follow up on unpaid accounts.

Make sure your workers understand their roles in realizing revenue. And give them adequate training and tools to get the job done efficiently.

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2. Streamline the billing process. You can't collect what you don't bill. Set up formal procedures that trigger the creation of an invoice as soon as the delivery truck pulls away from your dock. Electronic billing systems allow companies to send real-time invoices via email or text. Most e-billing

systems also enable online payment and purchase orders, as well as automatic re-orders, if applicable.

3. Assign dedicated collection personnel. Dedicated representatives should be assigned to handle each customer's billing issues. This allows your office staff to develop a rapport with customers. They should monitor all news accounts closely at first and become more flexible as the relationship develops.

4. Manage overdue accounts. Someone, possibly your controller or finance officer, should be in charge of monitoring aging. Each week, he or she should report to the owners about the percentage of receivables in the 0–30 days category, 31–60 days category, and beyond. Doing so allows you to detect *and reverse* negative patterns before they have a business impact.

Develop a timeline for acting on overdue accounts. For instance, after 45 days, you might call or send a reminder text to customers who haven't responded after the first bill. By pursuing these accounts before too much time has passed, you send the message that the company intends to get paid but is willing to work with the customer to resolve payment-related questions or problems.

5. Provide performance incentives. Too often, incentives are based on revenues, not profits or cash flow. Consider structuring your incentive program based (at least partially) on collections. For example, offer a bonus to workers if the company has 50% or more of accounts receivable in the 0–30 days category or keeps bad debt write-offs below 5%.

6. Consider factoring. It takes time to rein in collections. If your company needs immediate access to cash, factoring can be a short-term solution. Here, your receivables are sold to a third-party collection agency, usually for 60 to 85 cents on the dollar. This may seem expensive, but it can provide instant cash and free up employees for implementing long-term collection improvements. ■

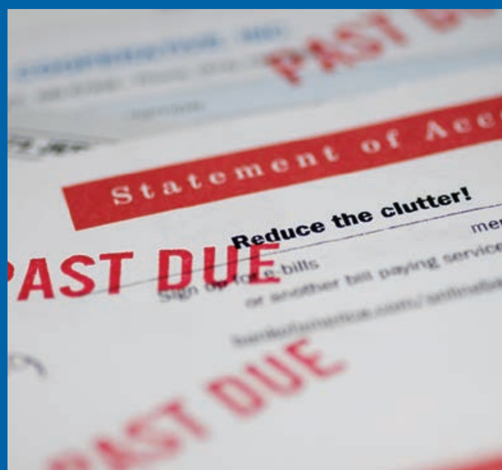
Tax breaks for bad debts

After repeated unsuccessful attempts at collection, you may eventually realize that a customer isn't going to pay. When it's time for a write-off, the Internal Revenue Code (IRC) offers a tax deduction for business bad debts that may soften the blow.

Under IRC Section 166, a business bad debt is a loss from the worthlessness of a debt that was created or acquired in your trade or business, or was closely related to your trade or business when it became partly or totally worthless. Most bad debts involve credit sales to customers for goods or services. But they can also include:

- Bona fide loans to customers or suppliers that are made for business reasons and have become uncollectible,
- Business-related guarantees of debts that have become worthless, and
- Debts attributable to an insolvent partner.

To qualify for the deduction, you must show that you've taken reasonable steps to collect the debt and there's little likelihood it will be paid. You also must have previously included uncollectible credit sales in your accrual-basis gross income. If you're unsure whether you qualify for this deduction, contact your tax advisor.



Strategic alliances: Leverage strengths, minimize weaknesses

The merger and acquisition market has been hot for manufacturers in the first half of 2016, and the momentum is expected to continue through year end. Some business owners are uncertain about buying and selling, however.

A strategic alliance may be a worthwhile alternative for gun-shy owners. Over the short term, it offers the best of both worlds: You retain control over your business while having access to your partner's resources. Over the long run, a strategic alliance provides an opportunity to test whether your partner could be a good fit for a future merger.

Is a strategic alliance right for you now?

Think of a strategic alliance as a near-term growth and expense-cutting mechanism that offers potential long-term benefits. Initially you should focus on such objectives as better economies of scale. For example, by combining orders for everything from raw materials to office supplies, both companies may qualify for supplier discounts and be able to reduce overhead costs.

Or you may want to find a partner to:

- Improve transportation logistics by consolidating warehouses,
- Jointly purchase manufacturing equipment,
- Upgrade your IT network or accounting system, or
- Share intellectual property such as customized software.

Additionally, a strategic alliance could help you build a presence in an unfamiliar market sector. For instance, your partner's more experienced sales team could be instrumental in introducing your products to new geographic territories where your partner is already well known.

What will the partnership evolve into?

Successful alliances also help the partners envision what a permanently combined organization might achieve. It's not uncommon for a strategic alliance to begin informally or as a short-term agreement and eventually lead to a merger when the two companies realize that together they're more than the sum of their parts.

A prior relationship can improve the chances that the merger process will go smoothly. Before joining in a strategic alliance, companies typically perform due diligence on each other and consult with their legal advisors.

Financial and other conditions can certainly change between the initiation of a strategic alliance and the beginning of merger negotiations. But a good alliance

allows companies to keep tabs on each other. If one of the companies experiences leadership challenges or has trouble getting financing to make a major purchase, the other is likely to know about it. Such knowledge can speed up the M&A transaction process and make integration much simpler.

What's your backup plan?

Unfortunately, strategic alliances don't always last. If the alliance is merely puttering along — or worse, proving a drain on resources — you need to take immediate action.

Some problems can be fixed. For example, it's easy for alliances to drift from their original purpose. A partnership forged mainly to upgrade information technology could wind up focusing on improving employee productivity, with mixed results. In this case, the partners should work together to bring the organizations' focus back to the agreed-upon set of goals. If the goals aren't clear, the partners should clarify them.

Other problems are irreparable. Your partnership agreement should specify conditions and processes for unwinding the relationship if the need arises.

Who will be your partner?

The key to successful strategic alliances is finding the right partner. It's often a competitor, supplier or customer — but it also could be a company outside your supply chain that's looking to expand into new markets. Your legal and financial advisors can help find a partner that's a good fit today and has the potential to grow with your business over the long haul. ■

The importance of using qualified employee benefit plan auditors

If your company provides an employee benefit plan and it has 100 or more participants, you're generally required to have the plan's annual report (Form 5500) audited under the Employee Retirement Income Security Act of 1974 (ERISA). Plan administrators have fiduciary responsibilities to hire independent qualified public accountants to perform quality audits.

Watch out for deficiencies

A recent study by the U.S. Department of Labor (DOL) revealed that four out of 10 employee benefit plan audit reports contained major deficiencies with respect to one or more relevant Generally Accepted Auditing Standards (GAAS) requirements. These deficiencies would lead to rejection of a plan's annual report and put approximately $653 billion and 22.5 million plan participants and beneficiaries at risk.

Of the 400 plan audit reports reviewed, 17% failed to comply with one or more of ERISA's reporting and disclosure requirements. The DOL's findings underscore the importance of selecting an experienced accountant who specializes in handling employee benefit plan audits.

Select a qualified auditor

In addition to requiring employee benefit plan auditors to be licensed or certified public accountants, ERISA guidelines require auditors to be independent. In other words, they can't have a financial interest in the plan or the plan sponsor that would bias their opinion about a plan's financial condition.

Experience is another important selection criterion. The more training and experience that an auditor has with plan audits, the more familiar he or she will be with benefit plan practices and operations, as well as the special auditing standards and rules that apply to such plans. Examples of audit areas that are unique to employee benefit plans include contributions, benefit payments, participant data, and party-in-interest and prohibited transactions.

Ask questions

The conclusion of audit work is a good time to ask such questions as the following:

- Have plan assets covered by the audit been fairly valued?
- Are plan obligations properly stated and described?
- Were contributions to the plan received in a timely manner?
- Were benefit payments made in accordance with plan terms?
- Did the auditor identify any issues that may impact the plan's tax status?
- Did the auditor identify any transactions that are prohibited under ERISA?

In addition to providing an opinion, your auditor's report will highlight any problems unearthed during the audit. Experienced auditors can suggest ways to improve your plan's operations.

Protect yourself and your employees

Employee benefit plan audits offer critical protection to plan administrators and employees. Your company can't afford to skimp when it comes to hiring an auditor who is unbiased, experienced and reliable. If your CPA doesn't provide this service, ask him or her to recommend another specialist to audit your plan. ■

The ins and outs of using accountable plans to save taxes

When an employer pays an expense reimbursement or advance to an employee (regardless of whether the employee incurs or is reasonably expected to incur the expense), the IRS considers the arrangement to be disguised taxable compensation to the employee. In other words, the purported expense reimbursement is treated as additional taxable compensation.

But when the employer makes these payments under a so-called "accountable plan," they're free from federal income and employment taxes for recipient employees. Additionally, the employer benefits because the reimbursements aren't subject to the employer's portion of federal employment taxes.

Accountable plan basics

Accountable plans are required to meet four requirements in order for payments to recipient employees to qualify as tax-favored expense reimbursements, rather than taxable compensation:

1. Business connection. Reimbursements or allowances can be paid only for expenses incurred by employees in connection with performing services for the employer. A common example is business-related travel expenses.

2. Substantiation. Expenses must be substantiated by an expense report or similar record. Receipts should be required for expenses over $75. For

lodging expenses, receipts are required regardless of the amount.

Rather than reimbursing employees for actual expenses, an accountable plan can instead pay predetermined mileage or per-diem travel allowances up to the amounts paid to federal employees. Companies that opt for this simplified method don't need their employees to substantiate actual expense amounts.

3. Return of excess payments. Within a reasonable period of time, employees must be required to return reimbursements or advances that exceed actual substantiated expenses. Under an exception, employees aren't required to return excess mileage or per-diem travel allowances based on the amounts allowed to federal employees.

4. Reasonable time. Substantiation of expenses and the return of excess payments must occur within a reasonable period of time.

In a 2009 private letter ruling, the IRS concluded that a company plan that reimbursed employees for the cost of providing their own job-related tools and equipment qualified as an accountable plan. The employer required that managers approve the expenditures and that the tools be kept on company premises and used exclusively for work performed for the company.

Other reimbursement arrangements

Unless your company's plan qualifies as an accountable plan, the IRS will treat expense reimbursement or advance payments as additional taxable compensation. Examples of arrangements that won't qualify include: 1) designating part of an employee's salary as a travel allowance, and 2) reimbursing expenses out of the employee's salary by reducing his or her paychecks by the reimbursed amounts.

To illustrate: Suppose ABC Manufacturing Co. operates expense reimbursement plans for its warranty repair technicians and salespersons. On any day a repair technician travels away from home on business, ABC designates $50 of that day's pay as an allowance for travel expenses. The technician receives the $50, but his or her salary is reduced by that amount. The technicians aren't required to substantiate actual travel expenses.

ABC also designates $500 of each salesperson's monthly salary as an allowance for monthly business-related entertainment expenses. The salesperson receives the $500, but his or her monthly salary is reduced by that amount. Salespeople aren't required to substantiate actual entertainment expenses.

These arrangements do *not* qualify as accountable plans because the allowances are paid regardless of whether the recipient employees actually incur business-related expenses and because the allowances are actually just part of the employees' salaries. Therefore, ABC must report the allowances as taxable wages on the recipient employee's W-2 forms.

The allowances are subject to federal income and employment taxes. ABC must withhold for federal income tax and the employee's portion of federal employment taxes on the allowances. ABC also must pay the employer portion of federal employment taxes on the allowances.

Creating your accountable plan

Setting up an accountable plan for employees' business-related expenses can save taxes for both the employees and the employer. Consult your tax advisor for more details. ■

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