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A NEWSLETTER FOR THE MANUFACTURING & DISTRIBUTION INDUSTRIES

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LESSONS FOR A NEW ECONOMY

How to Work with the Bank

Access to credit is perhaps the biggest challenge facing manufacturers and distributors today. Left in a weakened state by the recession, many have little left to attract lenders. Their inventories are reduced and they have foregone capital expenditures, using that cash to fund operating losses and debt service. "You've got to have money to make money," the old saying goes, but finding it is more difficult than ever. Yet somewhere out there, banks are lending. Certainly, they are being more cautious than ever, but most banks do have money to lend. So yes, there is money to be had by manufacturers and distributors who position themselves correctly.

What's the secret to unlocking the vault? As a potential borrower, it is important to understand what bankers are looking for when making lending decisions.

Be Realistic

Consider typical lines of credit. Most are based on the idea that current assets will be converted to cash within the next 12 months, and that cash will be available for debt service. Realistically, a fair amount of that cash is reinvested in new receivables and inventory. So with most lines of credit, what borrowers perceive as a "short-term" loan is actually a permanently revolving investment in current assets. "As long as the lender is willing to renew the line of credit every time it matures, this works fine. But more often than not, that is not happening in today's market," says Keith Friedlein, Partner-in-Charge of the Manufacturing & Distribution Group, Wolf & Company LLP.



Lesson: Be realistic about your financing needs and be prepared to offer a cogent repayment plan. You may be asked to take your line of credit to zero periodically, and that will require ready cash.

Tell the Whole Story

Banks are lenders, not investors. At some point, they expect to be paid back. Only cash repays loans, so banks are very interested in how a business generates and uses its cash. Borrowers often believe that the highest and best use of cash is as working capital to grow the business. Lenders, burned by business owners who grew their businesses and their lavish lifestyles, are now focused on understanding the borrower's total financial picture, often referred to as global cash flow.

This means the bank wants not only financial statements and tax returns for the business, but comprehensive financial information for all the entities

WORD TO THE WISE

Employee Fraud: Is Someone Stealing From You?

According to the Association of Certified Fraud Examiners (ACFE), American businesses lose 7 percent of their revenues to fraud each year. While the median fraud loss across all industries is approximately \$175,000 per year, it's even worse in manufacturing, where the median annual loss is \$441,000.

No company can afford that. So, what can the owner of a

Fraudsters often give clues to their fraudulent behavior. For example, they are often experiencing personal financial troubles at the time of the fraud, or are clearly living beyond their means. In nearly two-thirds of cases, they act alone.

"Asset misappropriation" tops the list of types of occupational fraud. This broad category includes such schemes as billing and payroll fraud,

or fudge their expense reports. If executives are loose with company money, employees may feel that they can be loose, too.

Internal controls. According to the ACFE, a lack of internal controls was the most commonly cited factor that allowed fraud to occur. One easy way to diminish the opportunity for fraud is to improve the segregation of employee duties. Be sure that one person isn't in charge of accepting, recording and handling both incoming and outgoing monies. Separate the initiation and approval of payments.

Also, shake up responsibilities periodically, and insist that all employees take their allotted vacations. Sometimes people who exhibit excessive ownership and accountability in their jobs are actually trying to hide something.

Employee education. Interestingly, nearly half of all fraud cases are discovered via a tip or complaint from an employee, vendor or customer. Creating an open-door policy and an anonymous way to report suspicious activity can go a long way toward uncovering fraudulent behavior.

Reinforce the idea that fraud hurts everyone in the company. It causes not only financial damage, but also damage to company morale and productivity. It's important to be proactive about fraud prevention. Conduct surprise audits periodically, and talk about fraud detection and deterrence openly.

Bottom line: Don't lose what you have worked so hard to build. Consider taking steps like those described here to help prevent fraud at your company. ■

For more information on fraud prevention and internal controls, call David Kot at 630-545-4518.



manufacturing or distribution business do to protect the company from such devastating losses? The first step is to learn more about occupational fraud and how it is perpetrated.

A Look at the Perps

The ACFE's Report to the Nation notes that fraud perpetrators usually work in the accounting department or upper management.

Accounting personnel most often are involved in check tampering schemes, while executives are more likely guilty of corruption or financial statement fraud. The higher up they are, the more expensive the fraud.

check tampering and inventory theft. Unfortunately, many of these schemes are ongoing, not one-time incidents. Check tampering and fraudulent financial statement schemes typically go on for as long as 30 months before detection.

Stop, Thief!

Fraud prevention experts suggest these steps to reduce the likelihood of fraud:

Zero tolerance. Integrity starts at the top. When the boss follows the policies and procedures, it sets a great example for employees to do the same. This means that owners and managers can't "borrow" money from petty cash, give themselves a quick loan to cover personal items,

Recession May Make Gifting Timely

Many manufacturing and distribution companies have taken a hit over the past few years. In many cases, markets are down, profits are down and values are depressed. But this bad news may actually be good news for some manufacturers and distributors when it comes to their estate and gift planning. Lower business value means lower stock value, which can have positive implications for gift and estate tax purposes.

By gifting the stock at a lower value, the owner can:

- Give away more of the company's stock per year and still take advantage of the annual gift exclusion of \$13,000. This amount can be doubled if both the owner and his or her spouse use their annual gift exclusions.
- Transfer a greater percentage of the company's value faster, which can significantly reduce the value of the owner's estate and therefore reduce his or her estate tax burden.

While the estate tax is gone in 2010, it's due to come back in 2011 at a whopping 55 percent, so reducing the estate now can mean big savings for your beneficiaries.

- Take advantage of estate and gift tax valuation discounts for stock in closely held companies (minority discounts and lack of marketability discounts) while still maintaining control of the company. Note that there is legislation currently proposed in Congress that would severely limit or disallow these discounts, so gifting sooner rather than later may be wise. If the economy recovers and the value of the company goes up, the owner has essentially given away stock at a bargain value, with substantial tax benefits.

How to Do it Right

The first step in gifting company stock is having a frank discussion with a trusted advisor. He or she can help you decide whether a gift is appropriate for family members, and if so, when the gift should be given and at what level.

Another consideration is which family members should receive gifts of company stock. It may make sense to give shares to children working in the company, but not to children who are not involved. A CPA can help figure out gifting alternatives that make sense.

In addition, a valuation of the company must be done for gifting purposes. Be sure to work with a valuation professional who is familiar with manufacturing and distribution companies and knows about IRS gift and estate valuation requirements. The professional must be properly credentialed and able to defend the valuation conclusion based on experience and expertise.

Finally, recognize that all gift and estate planning must be done with long-term goals in mind. The strategy may take years to implement, but there's no time like the present to get started. ■

For more information please contact Jeff Conrad at 630-545-4587.

How to Work with the Bank

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the borrower is involved in. This includes personal financial statements and tax returns, especially for borrowers organized as S corporations and LLCs.

Lesson: *Be prepared to verify and validate income from all ownership interests. Show that you are willing to endure a little pain and sacrifice by adjusting your personal lifestyle. Reduce lender frustration by having current financial information available and be prepared to present financial data even if you have not filed your tax return or are on extension.*

Show a Recovery Plan

Today's loan will be paid with tomorrow's cash flow, so lenders are interested in the company's future. For manufacturing and distribu-

tion companies, lenders want to see a realistic recovery plan, with solid projections and their underlying assumptions. They want to know that you have a viable core business and a value proposition that distinguishes you from your competitors.

Let them know how you will cover any losses you're incurring now. What changes are you making in management or other areas to position the company for success? How are you planning to support the company's need for new equipment and other major capital investments?

Lesson: *Be ready to show why and how your sales and receivables will grow and how you plan to finance the growth. Pre-*

pare to demonstrate an ongoing ability to keep debt service current and to reduce future financing needs by managing inventory, receivables and fixed costs.

Before approaching lenders, work with your financial advisors to prepare the documentation you'll need for fruitful discussions with bankers. Having a sound value proposition, realistic financing expectations and a workable recovery plan may convince them that you are worthy of their attention — and their financing. ■

For more information, contact Keith Friedlein at 630-545-4505.

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Revaluing Property Under IFRS

As adoption of International Financial Reporting Standards (IFRS) continues to move forward around the world, companies are becoming more aware of the differences between international accounting standards and generally accepted accounting principles (GAAP) used in the U.S.

One of the significant differences – and one that generally favors manufacturers and distributors – is the ability to revalue property, plant and equipment (PPE) at fair value under IFRS.

The revaluation option allows an entity with a significant amount of unreported appreciation in its land and buildings to strengthen its balance sheet overnight.

One Time Only

The revaluation option is only available once, upon initial adoption of IFRS. Subsequent to initial adoption, the company reports PPE under either a cost model or a revaluation model.

The cost model uses historical cost less accumulated depreciation, similar to GAAP. The revaluation model allows entire classes of assets (such as land, buildings, machinery, vehicles, furniture, fixtures and office equipment) to be revalued at fair value.

If the company chooses the revaluation model, IFRS requires that it continue to do so "... with sufficient regularity to ensure that

the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date." Typically, businesses perform revaluations every three years.

Revaluation allows a company to present a more realistic picture of its assets. For example, if a company acquired its land and buildings 30 years ago, that property has been accounted for under GAAP at historical cost and is therefore likely to be undervalued. In the end, revaluing PPE at fair value presents a more current, and perhaps more attractive, picture to banks and other third parties. ■

Interested in learning more? We will be glad to discuss IFRS with you.