

Manufacturer

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Can you benefit from the R&D credit?

The research and development (R&D) tax credit can help support manufacturers' innovative efforts, but some companies are still approaching research gingerly. Given the credit's history, that's understandable, but the tax advantages mean you should take a second look.

What is it?

The R&D tax credit expired for the 13th time at the end of 2007, and wasn't renewed again until the Emergency Economic Stabilization Act of 2008 (EESA) was signed into law in October 2008. Despite strong bipartisan support for making the credit permanent, EESA only extended the credit for 2008 (retroactive to Jan. 1) and 2009. (It's possible that by the time you're reading this article, however, the credit may have been extended again or even made permanent. Check with your tax advisor for the latest information.)

Under EESA, some manufacturers may be eligible for a credit for up to 20% of qualified R&D spending in excess of a certain amount based on the company's historical activity. For those who don't qualify for the full credit, the legislation increases the Alternative

Simplified Credit (ASC) rate to 14% for 2009, while eliminating the Alternative Incremental Credit. Regardless of which benefit you claim, your company must prepare in advance.

The R&D credit is based on a manufacturer's increase in R&D activities measured as a percentage of revenue over a historical baseline.

Although the R&D credit is used by a lot of manufacturers, there are still many that don't take advantage of it. Some don't qualify for the credit, while others may be dissuaded by the complexity of the rules surrounding it.

What's required?

The R&D credit is based on a manufacturer's increase in R&D activities measured as a percentage of revenue over a historical baseline. If R&D expenditure growth outpaces revenue growth, you probably qualify. If, however, your R&D-to-sales ratio is lower now than during the base period (1984-1988), you can qualify for the ASC of 14% of the excess of your current year research expenses over 50% of your average R&D expenditures for the last three years.

Your tax advisor can help you decide which credit is appropriate, as well as how to document and claim the credit. This may require that you set up project accounting processes that will support your claims, as the IRS has designated the R&D credit a "Tier One" issue. That means they use a standardized process to audit credit claims, and examiners focus on documents created at the time the research was performed.

What do you need to do?

To protect your tax advantage, thoroughly document your R&D projects. Establish project files and accounting processes immediately, and track progress and results during the project's life.





Why do it?

It may seem daunting to create the records you'll need to claim the R&D credit, but it will be time well spent. Not only will you see a tax reduction for the current year, but you may qualify for refunds if you can capture and recover credits for previous years.

Additionally, the R&D credit is a substantial tool to maximize your company's value. Manufacturers rely on research to bring new products to market, and new products can increase market value, cash flow and your return on investment. They also help keep U.S. manufacturers competitive in the world market.

Then use these guidelines to prepare yourself to withstand an IRS audit:

- Note significant dates from concept to commercialization.
- Work with your tax advisor to create narratives that discuss each project's R&D credit qualifications.
- Link employee hours and activities to specific projects.
- Use calendars and other supporting documents to bolster timesheet entries.
- Identify supplies used in R&D for each project and segregate them in a separate general ledger account.
- Obtain work orders, itemized invoices or other documentation from contractors demonstrating the work performed on R&D activities.
- Specify who is assuming the financial risk and who will retain intellectual property rights for each project.

Risk and intellectual property assignments are required to claim the R&D credit, and the IRS has been critical of less-detailed methods of quantifying costs. Establish tracking systems that justify your claims.

The IRS doesn't require manufacturers with several R&D projects to document each of them individually. Instead, you may use a statistical sample; a judgmental sample isn't acceptable. Consult your tax advisor on how to assemble a sample that holds up to IRS scrutiny.

Take advantage

According to the National Association of Manufacturers, 18,000 companies use the R&D credit each year, with 70% of the credit dollars going to pay employees involved in R&D activities. That's an advantage you really don't want to miss. ■

Leasehold depreciation break extended, too

Manufacturers who used rented facilities as part of their operations may also benefit from another provision of the Emergency Economic Stabilization Act of 2008: the extension of the 15-year straight-line depreciation for leasehold improvements to include property placed in service before Jan. 1, 2010.

Qualified improvements include interior upgrades made more than three years after the building was placed in service, but not elevators, building enlargements or improvements to the building framework.

Manufacturers may depreciate such improvements over 15 years, rather than the 39-year depreciation schedule required for other improvements. Because as of this writing the extension is temporary, manufacturers who are considering leasehold improvements may want to complete them this year. But check with your tax advisor before taking action, because this tax break could be extended or expanded.

When it comes to collections, shoot straight

Demanding payment for your products may not be fun, but it's important. And in a weak economy, it may mean the difference between financial solvency and serious trouble. The challenge is to improve your collections without alienating either your employees or your customers. Fortunately, it can be done.

Time is not on your side

A good collection process is like a good employee: It starts working immediately. If you let overdue bills slide, your customers may start to assume they can ignore your due dates — with disastrous implications for your cash flow and profitability.

To prevent that from happening, start early. Ask your customers for their billing requirements, and how you can make it easier for them to pay on time. Work to meet those requirements, but if your systems can't accommodate them, be honest in saying so.

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Then be proactive in following up on your bills *before* they're due. If you send bills payable in 30 days, call each customer after 21 days. Make sure everything is all right with orders, and work to resolve any issues immediately, before payment is due.

Be accurate, be prepared, be polite

One of the most common — and most preventable — reasons for payment delays is confusion over invoices. Be sure that the invoices you're sending accurately reflect the work done for each customer. In other words, don't let your invoices offer any excuses to delay payment.

Accurate bills and follow-up reminder calls will help speed payments, but they won't eliminate overdue invoices. Sometimes you're going to have to call customers who haven't paid. When you do, be prepared, and be polite. Before you make the call, review all



the relevant paperwork and have it in front of you for reference. Then be professional in requesting payment.

One of the things you'll need to establish, particularly when the economy is in a slump, is whether the customer *can't* pay or merely *isn't* paying. If it's the former, be flexible. Collecting a little at a time is better than not collecting at all.

If a customer is lax, however, don't let yourself be sidetracked. Keep the conversation on the payment, and don't end the dialogue without a commitment that you'll be paid a specific amount by a specific date. If you don't receive the payment as promised, call back at least once a week until you do.

Also, prioritize your collection efforts. If a large customer owes you \$50,000 and 10 smaller customers owe you \$2,000 each, focus on the large vendor first. It's fine to treat them all equally if you have the resources, but getting the big accounts current first will do more to protect your cash flow, delinquencies, days sales outstanding — and your bottom line.

Collect what you deserve

There's no one right answer on how to manage your collection process, but failing to manage it at all can be disastrous for your manufacturing company. Making collection calls may not be pleasant, but you've earned what you're owed. You deserve to collect it. ■

MEP centers can boost your competitive position

Manufacturers of all sizes are thinking lean, training employees in needed skills and looking for new ways to compete in today's global markets. But smaller manufacturers can be at a disadvantage.

They have the knowledge and the vision to succeed, but may lack the resources and capabilities to follow through as they would like. These manufacturers are the reason the National Institute of Standards and Technology established the Manufacturing Extension Partnership (NIST MEP).

National network

The NIST MEP is a nationwide network of resources that smaller manufacturers can draw on for the tools and services they need to help level their playing fields. Extension centers and field offices in all 50 states and Puerto Rico work directly with manufacturers on training, technology and other needed resources.

Additionally, the centers connect manufacturers with government and trade organizations, universities and community colleges, and a host of other public and private resources to help them realize individual goals.

Companies that work with MEP centers report process improvements, management and employee skill improvements, and higher productivity growth, according to NIST. In some cases, state MEP centers have helped manufacturers strengthen in-house capabilities to reduce their reliance on external resources. In others, the more cost-effective approach has been to link manufacturers with appropriate third-party providers.

Either way, manufacturers benefit. In fact, the federal Government Accountability Office reported that MEP clients showed improvements in sales, product quality, worker productivity, customer satisfaction, workplace technology and, most important, profits after using MEP programs.

Creative efforts

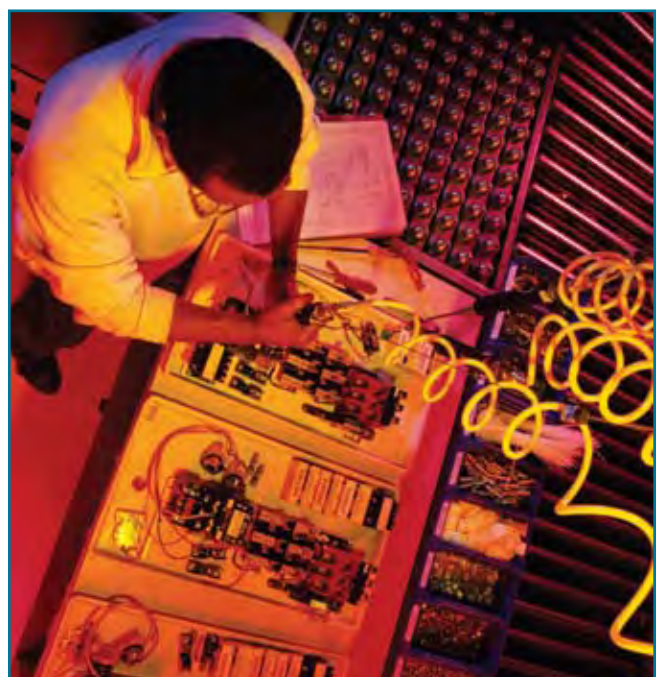
In the 17 years MEP has existed, its centers have developed creative approaches to manufacturing

success. In the Dakotas, for example, the MEP launched a lean enterprise certification program. Training for employees from company presidents to floor supervisors is spread over three months to accommodate smaller manufacturers' schedules, and results in continuous improvement efforts tailored to each company's needs.

In Chicago, the Waste to Profit Network was organized to bring manufacturers together to reduce waste. Operating on the principle that one company's waste could be another company's treasure, the network links firms that create waste-reduction synergies. A glass fabricator's annual 1,200 tons of glass waste, for example, now goes to a countertop manufacturer rather than a landfill. Metal oxides in the coatings the glass company used meant the waste couldn't be recycled through conventional processes, but customers love the iridescent quality it adds to their countertops.

A helping hand

Manufacturers don't have to be large to succeed, but it never hurts to get a little help from a friend. Thanks to the NIST MEP, smaller manufacturers are getting it. ■



Slashing costs

Incorporate strategic service management and reverse logistics into your cost-reduction program

You've pared your operating costs to the bone, your logistics and supply chains are thrumming like well-oiled machines, and your workforce is sized to perfection. You've maxed out your production capacity and streamlined your lines. What else can you do to reduce costs while continuing to grow profits?

A few answers: Don't try to sell more product lines — try to reduce the number of products that are returned and stop thinking that customer service ends at the loading dock. In other words, incorporate strategic service management and reverse logistics into your cost-reduction program.

Strategic service management

One of the core principles in strategic service management is that post-sales service and support can be a manufacturing profit center. Companies that use strategic service management see customer retention and service response time as key performance indicators.

For example, simply optimizing the routing and scheduling of service technicians can lead to significant savings and improved service. If you pay an average of 50 cents per mile for every service truck on the road, and you have a fleet of 250 vehicles traveling

an average of 39,000 miles per year, you're spending \$4,875,000 annually to keep them rolling.

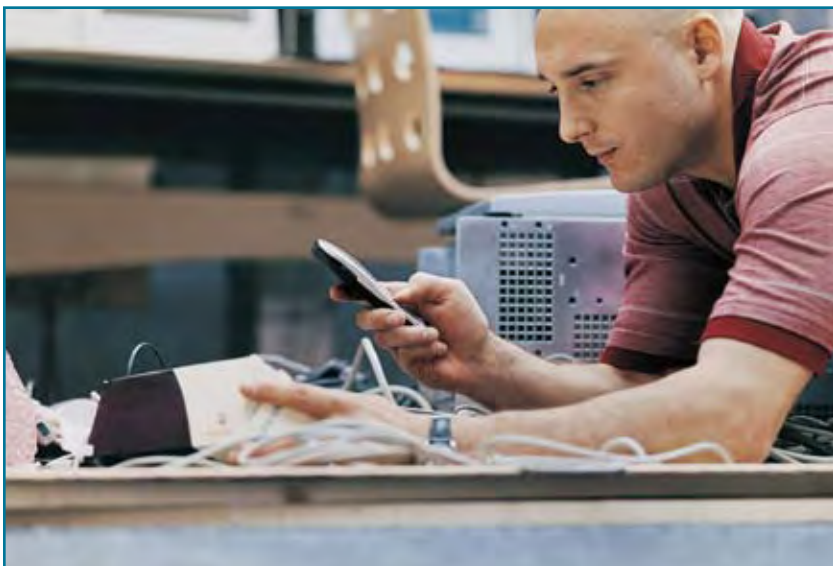
If you can cut 25% of those costs by ensuring your technicians don't spend half their time backtracking on their routes, you'll save \$1,218,750 in vehicle costs alone. Add the time savings and the additional calls the technicians can make as a result, and the savings are even more impressive.

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And if, on top of that, you can improve your service teams' first-call resolution rates, you'll be approaching best-in-class performance.

Effort required

Achieving strategic service management nirvana is not effortless. It requires significant up-front work and frequent follow-up measures.



A senior-level service executive must lead the process. Under his or her direction, your customer service team should develop systematic processes to capture customer-specific information that can be used to determine requirements and allocate resources.

Ask customers what they expect from your company, as well as what they need, and then devise service agreements and align internal business processes to meet those requirements. Next, tie what you learn to employee compensation. Set financial, operational and customer retention/service goals and reward employees for meeting them.

For example, perhaps your customers want to receive their orders faster. Offer your shipping and loading dock workers a bonus for cutting 10% from the time it takes them to package and load orders.

For greatest improvement, consider automating functions such as service parts management or warranty management. Anything you can do to make repairs and returns more convenient for your customers can pay big dividends in customer satisfaction.

Reverse logistics

Speaking of returns, the best way to make them more efficient is to eliminate them. The Aberdeen Group estimated in 2008 that product returns cost U.S. companies up to \$100 billion a year — an estimate that may be low, as reverse logistics costs often are hidden among business functions. According to Aberdeen, some manufacturers have established separate returns management groups to reduce the costs associated with returns that can run as high as 30% in some instances.

In conjunction with reducing product defects and shipping miscues that cause unnecessary returns, examine how returns are handled when they do occur. Standardized processes can help avoid misrouting and attendant transportation costs and delays.

Also consider an automated system as the cornerstone of your returns gatekeeping process. If a customer is returning a cell phone because it's three years old and due for an upgrade, you may want to route it to a site different from those designated for phones being returned because they're defective. Asking the customer to tell you the reason for the return up front enables you to send the proper address labels or other information the first time.

Change your perspective

As you become more adept at improving production and operations, you should look beyond the tried-and-true in your efforts to stay competitive. Strategic service management and reverse logistics programs may offer the first glimpse of a bright future. ■

Expanded ADA boosts employer responsibility

Recent changes to the Americans with Disabilities Act (ADA) extend coverage to more people in the workplace because of the ADA Amendments Act (ADAAA) that took effect Jan. 1. A "disability" is now defined as a physical or mental impairment that substantially limits one or more life activities, as well as a record of such an impairment or being regarded as having such an impairment. Transitory, minor impairments — those lasting six months or less — aren't included, and you aren't required to provide reasonable accommodations for those who have "regarded as" claims.

Another noteworthy change is that the ADAAA defines "major life activities" as caring for oneself, sleeping, eating, walking, hearing, and other mental and physical capacities, but also as major bodily functions such as immune system functions, cell growth, and endocrine and reproductive functions.

If someone has a condition in remission, that condition is now considered a disability if it would substantially limit a major life activity when active. And, with the exception of corrective eye lenses, you can't consider the effect of mitigating measures in determining whether someone has a disability.

In short, Congress made it clear that ADA coverage should extend to more people and that courts should focus on whether individuals have been discriminated against on the basis of a disability rather than determining whether they are covered by the ADA. As a result, employers should use an equally rigorous standard in applying ADA provisions to their workforces.

To ensure you're in compliance, make your managers and supervisors aware of the new law and consult your attorney about whether you need to make any changes to your policies and procedures.

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