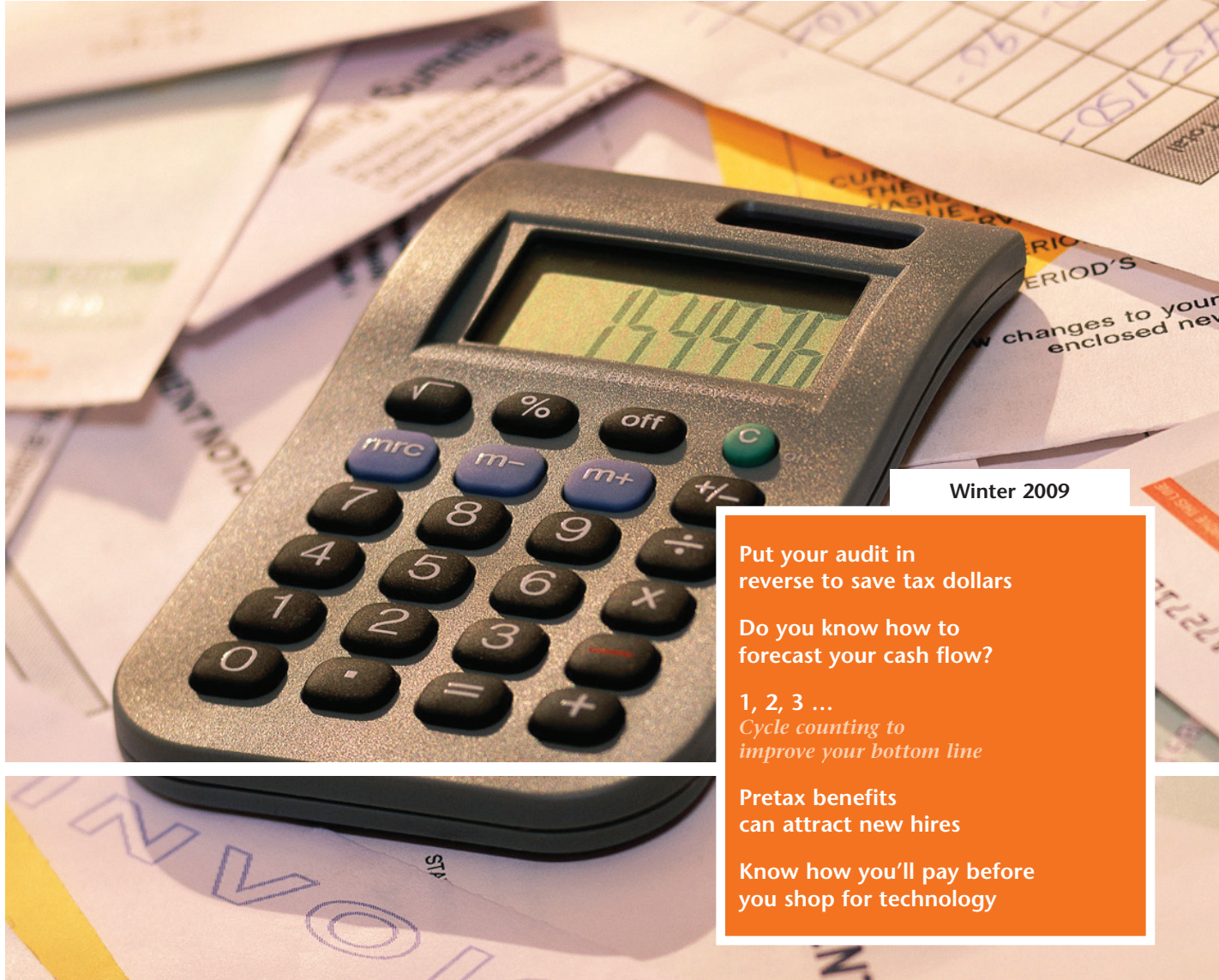


Manufacturer



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Put your audit in reverse to save tax dollars

It's a safe bet that Uncle Sam will let you know if you haven't paid enough sales and use taxes, but what are the odds that you'll be notified if you've paid too much? The chances are slim — so slim that many manufacturers use reverse audits to find overpayments and seek reimbursements on their own.

Get what's coming to you

In most states, manufacturers are exempt from sales tax on equipment used in manufacturing or recycling, and many states don't require them to pay taxes on the utilities and chemicals they use, either. In some states, custom software, computers and peripherals are exempt if they're used for research and development projects.

With most state sales taxes now between 4% and 7%, it's worth it to be sure you're receiving all the exemptions to which you're entitled. And unless you're diligent about claiming exemptions, you're probably missing out on some.

Most manufacturers have sales and use tax compliance systems to guard against paying too much, but if you haven't reviewed yours recently, it may not be functioning properly. Employee turnover, business expansion or downsizing, and simple mistakes all can take their toll on sales and use tax

compliance policies, and you may be paying more than you should.

Take a long view

A reverse audit should include an examination of your tax compliance systems as well as your purchasing records. For example, your accounts payable department may be tasked with spotting exemptions that purchasing hasn't requested, but are they doing it?

The audit should extend across your business, going back as far as the statute of limitations on state tax reviews. If your state auditors can review all records for the four years preceding the audit, for example, your reverse audit should encompass the same timeframe.

What types of payments should be reviewed? You may have made overpayments on components of your manufactured products as well as on the equipment you use to make the products. Other areas where overpayments may occur, depending on state laws, include:

- Pollution control equipment and supplies,
- Safety equipment,
- Warehouse equipment,
- Software licenses,
- Maintenance fees,
- Protective clothing, and
- Service transactions.

When considering whether you may have overpaid taxes in these and other areas, a clear understanding of your operations is key. You must know where your manufacturing process begins and ends, for example, if you want to ensure you're receiving maximum benefit from industrial processing exemptions.

Also remember that, if you have plants or sales offices in more than one city or state, your records may be decentralized. Don't overlook any sites.



Consider statistical sampling

Thanks to advances in technology, database software is available to help identify where overpayment is most likely to occur, select random samples of invoices for review and use the results to project total overpayments.

In some states, such statistical sampling is an accepted method for projecting overpayments. In others, you'll be required to complete a detailed review of all purchases. So before beginning a reverse audit, it's important to understand sampling requirements and tax exemptions for every state in which you do business.

Don't give more than your due

Reverse audits can be time consuming and complicated, but a little pain can bring significant gain. Use your reverse audit not only to reap tax refund rewards now but also to update your compliance systems to help ensure you don't overpay taxes in the future.

Rules and regulations surrounding state sales and use tax refunds are complicated. Work with your tax professional to understand them and ensure your refund claims are properly prepared before you submit them. ■

When is a good time to conduct a reverse audit?

If you're doing a major capital project such as adding manufacturing space, a reverse sales and use tax audit may be the last thing you want to add to your schedule. But it may be the best time. Even if you can't justify the effort a full, companywide audit would require, you can audit transactions associated with the project. Now is when you'll be buying equipment and supplies that are most likely to qualify for tax exemptions. If you can spot overpayments during the process, you can act to resolve them promptly.

Another good time to consider a reverse audit is when state tax laws change. Sales and use tax exemptions typically don't apply to local taxes, and changes in state regulations may be easy for your staff to overlook at first. If a state in which you do business has revamped its tax laws, use a reverse audit to be sure you're not missing additional opportunities for tax savings. Your tax advisor can help you stay up to date on tax law changes.

Do you know how to forecast your cash flow?

Cash flow forecasting is more an art than a science, but manufacturers who master it can sleep soundly at night. Whether you want to expand your business or just pay the bills, knowing where the cash will come from is a definite stress-reliever.

In a perfect world, money would flow in faster than it flowed out. That is, of course, every business owner's goal. The challenge is to make the money flow in at the right time, which is what differentiates positive cash flow from profitability.

Profit doesn't always equal cash

Profitable manufacturers can go out of business waiting for enough money to come in to meet payroll and pay suppliers. Let's say, for example, you receive a \$100,000 order that will cost you \$80,000 in wages and materials. You're likely going to have to pay out the \$80,000 a month or more before the \$100,000 comes in. If you don't have the cash on hand, that could be problematic. Cash flow forecasts can help ensure that you have the cash on hand.



Cash flow forecasts are predictions of the sources and amounts of cash that will come in and the recipients and amounts that will go out for a certain period. It's making the predictions that can be challenging.

Before you begin, understand that a cash flow forecast isn't a history lesson. It's a tool that gives you a glimpse of the future. Therefore, don't allow yourself to get bogged down in analyzing past performance.

Start simply

That said, you need real data and accurate commitments to generate a useful cash flow forecast. A simple forecast begins with the basics, including fixed expenses, variable expenses, estimated income and your bank statement, which gives actual income and cost figures for comparison to billed amounts and invoices.

Start out by looking at your fixed expenses for the last year (or a period equivalent to whatever period you want to forecast), and use those numbers to project your fixed expenses for that period. Fixed expenses include overhead, wages and other stable costs.

Don't rely on your memory; collect your actual bills — and compare them to your bank statement. Then consider variable costs such as fuel and materials. You can't predict exactly how these expenses will change, but you can chart them for a year to identify trends and establish averages.

Of course, you'll also need to consider whether your materials usage will remain steady. If you expect significant changes in demand during the forecast

period, adjust your variable cost estimates accordingly.

Approach your income forecast in the same way. Don't try to guess what may come in. Instead, base your forecast on what you know is in the works. You can group like income, such as from sales or investment interest, but remember that much of your income is likely to lag 30 to 60 days or more behind the work you do to earn it and enter it accordingly. If you know you'll ship an order in February for a customer whose terms are 60 days net, for example, you can't realistically show income from that order until April.

Plot your course

When you've estimated all your expenses and income for a year (or a quarter, if that's a better window for your company), enter them in monthly categories — such as utilities, labor, inventory, sales or taxes — to get a snapshot of what you'll need and what you'll receive each month. Seasonal fluctuations will be evident, as will any noteworthy trends, and you can plan adjustments in advance. After your forecast is in place, use it to measure your actual performance and see where adjustments are needed.

Profitable manufacturers can go out of business waiting for enough money to come in to meet payroll and pay suppliers.

If you anticipated \$300,000 revenue for September, but didn't expect an order that will require \$350,000 in expenses that month, for example, your cash flow forecast can help you decide how to make up the difference. If you're going to need a short-term loan to tide you over, you'll know that in time to get the financing in place.

See where you stand

Cash flow forecasts can be valuable business tools, but you must be honest with yourself. Don't gloss over performance issues, and don't use guesswork. Know exactly where you stand. ■

1, 2, 3 ...

Cycle counting to improve your bottom line

An inventory count is an annual rite for many manufacturers, but others have replaced that ritual with an ongoing cycle count — and improved operations at the same time. Cycle counting is the process of counting some stock items or warehouse locations every day.

What and how often to count

A successful cycle counting program should be ongoing to provide you with a perpetual, accurate picture of your inventory. You may decide to count certain units 10 times a year and other units five times a year, or to divide the counts among raw materials, finished products or work in progress.

In addition, you may want to count some critical raw materials every day or once a week; other slow-moving finished goods may need to be counted only once or twice a year. Regardless, cycle counting should become an accepted and routine part of your continuous improvement process.

To decide how often to count items, establish their importance to your operations. Classify inventory items as A, B or C according to their rank by annual usage in dollars.

If your orders (not actual deliveries) for a certain item represent \$15,000 in annual usage, for example, that item will rank higher than an item with only \$5,000 in annual usage. Class A items are those in the top 80% of total value, while the next 15% will be Class B items, and the remaining 5% will be C items. The items you categorize as Class A may change according to usage, but the percentage of Class A items should remain constant.

When you've ranked your inventory items, decide how often to count them. You may decide to count your A items every month, B items every quarter and C items annually. That doesn't mean you count all the A items on the same day every month. Rather, you count some A items every day of the month. Let's say, for example, you have 1,000 A items to count

each month. Over the course of a year, that translates to 12,000 counts. If you work 240 days a year, you'll need to count 50 A items per day.

If you also have 1,500 B items to count every three months, that translates to another 6,000 counts per year, or 25 per day. Thus, every day you'll count 75 items — plus however many C items are required to ensure that every C item is counted once a year.

Reliable inventory records

Cycle counting can eliminate many of the errors associated with annual counts, and you can rely on your inventory records. If a customer wants 500 of a certain item in three days, you know at a glance whether you have it in stock. And improved customer service translates to increased revenues.

In addition, it costs less to maintain accurate records than it does to find and correct errors in existing records. If you haven't considered cycle counting, it may be time to talk to your financial advisor about its potential benefits. ■



Pretax benefits can attract new hires

Baby boomers are getting ready to retire, and the competition for skilled workers to replace them is heating up. You need to offer more than a good salary to stand out from the crowd, but what can you do? The answer may lie in pretax benefits.

Pretax benefits are those that employees pay with money you reserve from their earnings before taxes. In addition to allowing employees to save income and FICA taxes, providing certain pretax benefits may allow you to help them pay for rising costs, and you don't have to pay FICA taxes on the amounts you hold in reserve.

What can you provide pretax?

The best-known example of a pretax benefit is probably the employer-sponsored retirement plan, such as a 401(k) plan. (Note that contributions to 401(k) plans are pre-income-tax only — they're still subject to FICA tax.) But there are many other types of pretax benefits you can provide. Some that you might consider offering include:



HSAs. One pretax benefit gaining popularity is the Health Savings Account (HSA), which must be coupled with a high deductible health plan (HDHP). To qualify as HDHPs, policies must have annual deductibles of at least \$1,150 for individuals and \$2,300 for family coverage.

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Through pretax payroll deductions, employees put the amount they save in insurance premiums into HSAs, which can then be withdrawn tax free to pay for a variety of medical and dental costs. If you contribute or make matches on employee contributions, you aren't required to pay FICA taxes on those amounts.

Employees may use HSAs for qualified medical expenses, including vision, dental and some over-the-counter medications. Unused amounts can be rolled over to the next year. Maximum contributions for 2009 are \$3,000 for individuals and \$5,900 for families.

Tuition reimbursement. Another popular benefit that can attract employees and improve your employees' skills, tuition reimbursement encourages employees to seek additional training. Neither you nor the employee is taxed on the money used for tuition.

Tuition reimbursement plans vary widely. They may cover all or some of tuition expenses, and may or may not include the cost of textbooks, fees and other related expenses.

Child care reimbursement. One of the most burdensome expenses many employees face is child or dependent care. You can help by reimbursing a percentage or a fixed amount. Again, neither you nor the employee is liable for taxes. Child care includes day care, nursery schools, before- and after-school

programs, and private sitters. The maximum reimbursement is \$5,000 per year.

Life, disability and long-term care insurance. One of the more relatively inexpensive pretax benefits you might offer is insurance coverage. You deduct the cost of premiums from employees' paychecks before taxes, while using your group buying power to offer coverage at lower rates. Employees don't pay taxes on the premiums you pay and, in most cases, the insurance coverage you offer is deductible for the business. Keep in mind that there is a \$50,000 limit on life insurance coverage, but not on disability, long-term care or special coverage such as cancer insurance.

Commuter costs. In an effort to encourage use of public transportation, more employers are deducting the cost of that transportation from employees' paychecks before taxes. Participating employees reduce their FICA and federal income tax costs, and may see

lower state income tax liability, as well. Eligible costs include up to \$230 per month for carpool parking expenses or up to \$120 per month for mass-transit expenses in 2009. And, beginning in 2009, employers can exclude up to \$20 per month paid to employees who commute by bicycle.

Take the lead

The pretax benefits you offer should be determined by the makeup of your workforce. Younger workers may appreciate help with child care or tuition expenses, while older personnel may be more interested in insurance. Commuters of any age are likely to appreciate help with those costs.

Regardless of which benefits you select, pretax benefits can give you a leg up in recruiting the workers you'll need to carry you through the baby boomers' exodus. And that's a boost worth having. ■

Know how you'll pay before you shop for technology

Cutting-edge technology can provide tremendous efficiencies and cost savings down the road, but it can be expensive to buy for an entire manufacturing operation. That's why you should consider a technology funding plan. If you have a vision, a strategy and a structured approach to acquisition and implementation, you can buy technology that helps you achieve your objectives faster and more efficiently.

The first step to funding all of your technological needs is to include these expenditures in your long-term strategic plan. You can't expect to purchase everything in one year, but plan to introduce a part of the new system each year.

If your initial investment is going to be significant, you may need to seek lender financing. If that's the case, prepare your approach. Don't focus on the technology; instead, focus on what the technology will do and how any efficiencies it creates will help you repay the loan.

In addition, build a business case for everything you want to include — not only to make your funding request more appealing but also to give yourself a reality check. Will the expense of all of the bells and whistles actually benefit your company?

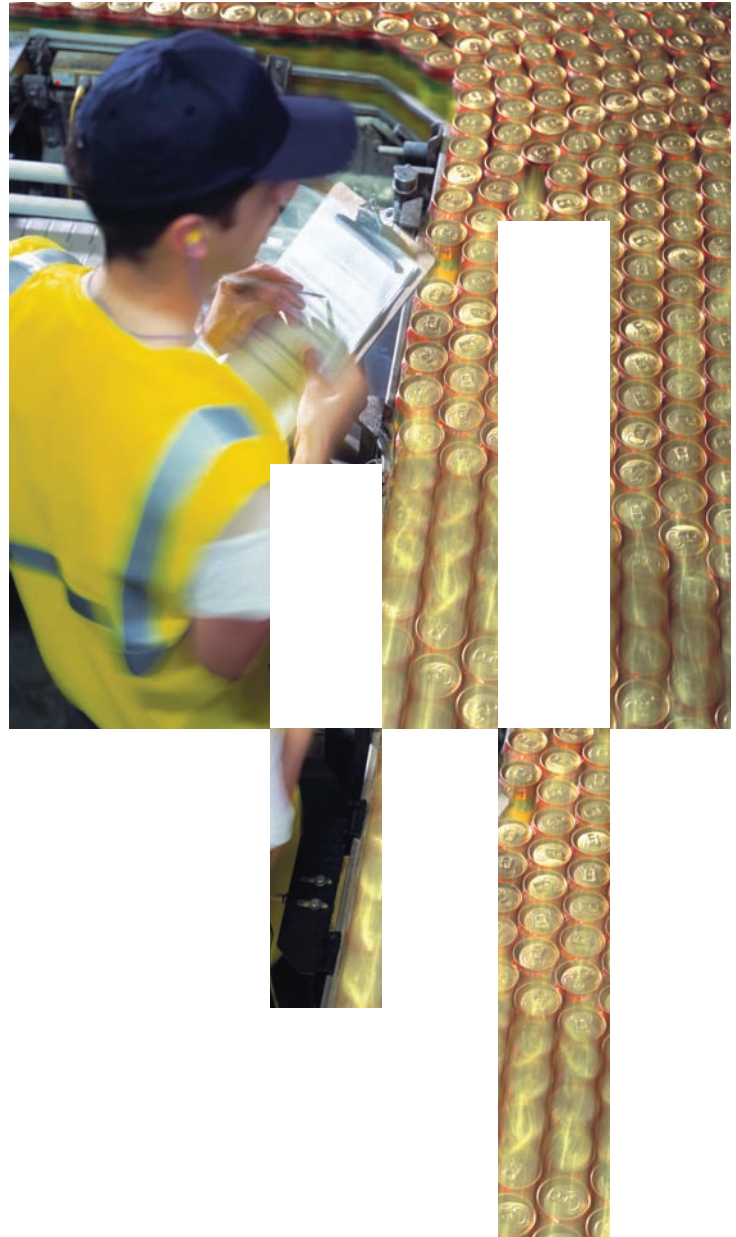
Remember, too, that technology isn't overhead. Budget it as its own expense, and be sure you've taken advantage of all existing financial, technological and human resources before determining how big to make the budget. Don't, however, continue to add "work-arounds" to an outdated system in an effort to get by.

Consider, too, training, speed of adoption, system performance, technology support and return on investment as you develop your plan. They all can add costs, and overlooking or miscalculating any of them can throw your funding plan into disarray.

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