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A NEWSLETTER FOR THE MANUFACTURING & DISTRIBUTION INDUSTRIES

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WHAT'S NEXT?

Transition Planning Ensures an Attractive Future

You plan for your vacations, for your kids' education and for other big events. So what's the hesitation about planning for the leadership transition of your business?

Transition planning rarely reaches the top of the to-do list for most owners. Jeffrey Conrad, a Wolf & Company Senior Tax Manager who works with clients on succession planning, suggests that "mapping out the future of your company now can have an enormous impact on where it goes and what it can do for you and your family. Whether you want to sell your business or transfer ownership to the next generation, deliberate planning offers substantial benefits."

What's In It for You?

A long-term transition plan will help get you and your business from where you are today to where you want to be in the future. To get started, consider your objectives. For example, when would you like to exit your business? Would you like to sell it to outsiders or an employee group, or leave it to your children? How much money do you need from the sale to live on after you leave?

The answers to these questions will impact your plan. They also set the stage for an honest inventory of your company's strengths and weaknesses relative to your long-term objectives.

Start with Benchmarks

A benchmarking study will illuminate how your business performance measures up against peers in the manufac-

turing and distribution industry. It will also highlight areas needing improvement. Your CPA can assist with this study and help you determine how your numbers compare in areas like gross margins, accounts receivable days outstanding, sales per employee, working capital investments, and leverage ratios, to name a few.



Once you know where you stand, you can tackle any problem areas.

Identify Opportunities

To be ready for a smooth transition, your company needs to be lean, mean and competitive. What can you do to improve the business and enhance its value? Scrub every area for opportunities to fine-tune. For example:

- **Evaluate your service and supply contracts.** Are there vendor integration or consolidation opportunities?
- **Look at your leadership.** Do you have the right people in the right jobs in production, R&D, materials management, maintenance and engineering?
- **Consider the profitability of each product line.** If you have loss leaders, are they doing the job of cross-selling higher-margin products?

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Top 10 Housekeeping Tips

Some people love surprises. Most business owners don't. Surprises are especially disturbing at the end of the month, when the numbers just aren't adding up. To avoid these kinds of "uh-oh's" and prevent fraud, owners of manufacturing and distribution businesses must stay on top of the details. Keith Friedlein, Partner-in-Charge of Wolf & Company's *Manufacturing & Distribution Group*, suggests considering these top 10 tips:

1. **Sign the checks.** In a perfect world, the company owner would sign all the checks. This level of control may not be realistic in larger organizations, but there are still steps you can take to monitor outgoing cash. For example, create a protocol for checks requiring two signatures.
2. **Open the bank statements.** Have bank statements delivered to your home address or delivered to you unopened in the office. Review them for unusual transfers or balance fluctuations. Look at the check payees to see if any are unfamiliar — or, in the case of a skimming bookkeeper, too familiar! Examine electronic transfers to see if any stand out.
3. **Reconcile accounts promptly.** Require checking account reconciliation within 10 days of bank statement arrival. Be sure your accounting staff promptly reconciles accounts receivable to sales and cash receipts, and accounts payable



listings and inventory counts to the general ledger. Insist that they alert you to irregularities.

4. **Verify vendors.** Regularly review vendor lists to ensure that the vendors actually exist and are not phantom payees. If you are no longer doing business with a vendor, confirm that the company is off the vendor list and that payments have stopped.
5. **Confirm sales forecasts.** Periodically compare the sales team's forecasts against reality. Inflated sales projections can cause expensive problems over time in terms of purchasing, staffing and production. Make sure you're basing important decisions on real numbers, not inflated forecasts.
6. **Watch the expenses.** Create strict standards for expense reimbursement and randomly monitor employees' credit card statements and expense reports. Note any un-usual expenditures and request further explanation. Do not permit personal expenses on company cards, and insist on petty cash documentation.
7. **Keep tabs on vacations.** Insist that employees take all of their vacation time, and be wary of those who hesitate to take time off. This is especially important in the accounting and bookkeeping arena, where fraud is often caught while employees are away on vacation.

Transition Planning Ensures an Attractive Future

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- **Assess your equipment.** Is it enough to take your company where you want it to go? Will upgrading your production line improve operations?
- **Size up your intellectual property.** Most manufacturers have significant IP investments. Do you have patents pending or maturing? If so, how will this impact your business?
- **Clean up your warehouse.** Be sure you're not carrying excess inventory, and also that you have enough of what you need. Too much or too little can cost you money.

Be deliberate in your assessment — area by area, department by department — and structure a plan to implement changes. Without a timeline attached, a plan is not really a plan — it's just a nice idea.

Don't Be Discouraged

All of this digging will no doubt highlight some areas of your business

in need of major work. You may have to overhaul a department, for example, or completely change a process. Don't let the tasks ahead scare you. Correcting deficits may take a fair amount of time — but that's why it's called long-term transition planning!

Many owners find it helpful to seek assistance from their trusted advisors. Share your plan and your timetable with your attorney, financial planner, insurance advisor and CPA. Consider scheduling a periodic check-in with this team to ensure that you stay on task.

The transition planning process may sound daunting, but it is important. It's the only way you can set a realistic course for the future and ensure that your company will deliver the payoff you desire.

We are ready to help you with your long-term transition planning. Contact Jeffrey Conrad at 630-545-4587 to get started today.

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Why Manufacturers & Distributors Love ESOPs

For many years, Employee Stock Ownership Plans (ESOPs) had a bad rap. Some owners considered selling to employees inferior to selling to an outside buyer. Others were concerned about the complexity of the arrangement, or simply misunderstood how ESOPs work.

But in today's market, with a questionable M&A environment, an uncertain tax situation and a bevy of baby boomers looking forward to retirement, ESOPs are skyrocketing.

Top 10 Housekeeping Tips

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- 8. Take inventory.** Require periodic counts of inventory and valuable supplies, performed by people who typically don't handle these items. Unusual deficits may alert you to a need for better security procedures.
- 9. Check the premises.** Speaking of security, are your alarms and video surveillance cameras working properly? They really do deter theft, and there's no point in having them if they're not used.
- 10. Follow up on anything that seems unusual.** It's good for employees to know that you're involved in and aware of the details. If you find something unusual, ask for an explanation and documentation.

While some of these steps may seem onerous, they will help create a more efficient and fraud-resistant operation. Good housekeeping is good business. ■

Our firm is familiar with best practices in these areas. Contact Keith Friedlein at 630-545-4505 to review your housekeeping procedures.

An ESOP is a qualified employee benefit plan that allows employees to become owners of the company. To set up an ESOP, the company typically establishes a trust into which the company makes tax-deductible contributions, allocated to each eligible employee. The ESOP then uses these contributions to buy company stock from the owner. Alternatively, an ESOP can take out a loan to buy the stock, and the company can make contributions to the ESOP to pay back the loan.

According to Kristine Domaracki, a Wolf & Company Senior Audit Manager with ESOP experience, properly structured ESOPs have many benefits:

Liquidity for the owner. An ESOP creates a buyer for the owner's stock, which may be especially helpful in difficult economic times. The owner can sell some or all of the company stock to the ESOP, and can also sell stock in stages, creating a gradual liquidity process.

Legacy for employees. If the company is sold to an outsider, there's no guarantee that the business entity itself will survive. With an ESOP, the company continues and jobs are preserved. The business may perform even better under an ESOP because employee-owners have more skin in the game.

Tax incentives for the owner. Without an ESOP, S corporation owners pay income tax on the profits of the business. But if the owner sells stock to an ESOP, the proceeds of the sale in excess of the basis are treated as capital gains rather than as ordinary income. Capital gains are taxed at a lower rate, which means significant savings for the owner.

If the company is a C corporation, once the ESOP owns at least 30 per-

cent of the stock, the seller can reinvest the proceeds in other securities and defer tax on any gain.

Tax incentives for the company. In an S corporation, the percentage of ownership held by the ESOP is not subject to federal income tax, nor (usually) state taxes. For a company that's 100 percent ESOP-owned, this means there are no income taxes at all on company profits. This can dramatically increase the company's cash flow.

In a company where the owner sells a partial interest, the company can make tax-deductible contributions to the ESOP and deduct the purchase price of the transaction over time.

Tax incentives for employees. Employees pay no tax on their ESOP distributions until they leave the company, at which point they can roll the proceeds into an IRA.

Ownership control. Owners can sell their interest to the ESOP and still maintain control of the company. Many owners enjoy this arrangement, knowing they can get cash out of the company but still run the business and receive reasonable compensation for the services they perform.

There are also downsides to ESOPs. For example, because they are qualified plans, they incur additional reporting and administrative costs. However, the many benefits they offer make ESOPs a great option for many owners of manufacturing and distribution businesses. ■

Interested in discussing an ESOP in more detail? We can help you determine if it's a good option for you and your employees. Call Kristine Domaracki at 630-545-4671 for more information.

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Ethical Behavior Starts at the Top

According to the Association of Certified Fraud Examiners (ACFE), the connection between fraud and an organization's "tone at the top" is clear. If company executives have questionable ethics, employees probably will, too.

The most recent National Business Ethics Survey conducted by the Ethics Resource Center reinforces this idea. According to the survey, employees who feel that top management acts ethically—for example, by talking about the importance of ethics, keeping employees informed, keeping promises and modeling ethical behavior—are much less likely to commit fraud.

Interestingly, the survey showed that falsification and misrepresentation of financial records constituted only 5 percent of the ethical violations reported. Other types of violations are more common and especially noteworthy:

- Violation of safety regulations (16 percent)
- Misreporting actual time worked (16 percent)
- Stealing, theft or related fraud (11 percent)
- Goods and services that fail to meet specifications (8 percent)

The ACFE suggests several steps to set the right tone at the top:

Lead by example. Employees will mimic management behavior. If you take

shortcuts or use abusive language, employees will, too. Or if your kids walk out with cases of goods, employees will do the same thing.

Establish a code of ethics. Create a clear statement describing expected behavior and insist that employees and contractors abide by it. Emphasize compliance standards through training.

Screen applicants. Conduct background and reference checks.

Assign authority and responsibility. Provide well-defined job descriptions and set realistic standards. Provide proper job training so employees can succeed. ■