

MANUFACTURING MONITOR



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What's the forecast?

A cash flow statement can help you track key financial information

High operating costs and low profit margins, coupled with tight credit and a shaky economy, can mean poor cash flow for manufacturing companies. Where is the money going? Where is it coming from?

A cash flow statement can help answer these and other important questions. This highly useful document allows you to track key financial information and, more important, forecast financial trouble. In fact, during these difficult times, it is often vital for companies to manage their business on a 13-week cash flow forecast.

A comprehensive view

Your company's financial statement is composed of three key parts: 1) a balance sheet, 2) an income statement and 3) a cash flow statement. All three statements comprise the same accounting information, but each one serves a different function.

The balance sheet provides a picture of your company's assets and liabilities, and the income statement indicates the business's profitability during a certain period. The cash flow statement, however, connects the two to provide a more comprehensive view of your finances.

For example, when analyzing your company's liquidity, cash flow information is more telling. Balance sheet data is more static, measuring a single point in time. And information from the income statement contains many arbitrary noncash allocations, such as pension contributions and depreciation and amortization.

By regularly analyzing cash flow statements, you can pinpoint reasons for negative cash flow, such as poor collections or changes in fixed assets and debt.

A cash flow statement reconciles both of these much in the same manner that a checkbook would reconcile a checking account. It records the changes in the other statements and nets out the bookkeeping, showing the amounts and sources of profits and losses for any given period. The cash flow statement also maintains records of your company's fiscal transactions.



3 areas of activity

If you're operating under the accrual method of accounting, sales and expenses often appear on financial statements before payment is received or made.

A cash flow statement converts financial data recorded on an accrual basis in the income statement and balance sheet to a cash basis. The statement shows sources of cash receipts, where cash is spent, and net change. To arrive at the net change, the statement focuses on three areas of activity:

- 1. Operations.** Operating activities are a company's daily internal activities that generate cash or require its expenditure. These include cash collections, operating expenses (such as rent, payroll, supplies and inventory) and income taxes.
- 2. Investing.** For manufacturers, investing generally involves the purchase or sale of equipment.
- 3. Financing.** Loans and leases that provide or require cash generally fall under financing.

You can measure cash flow using the direct or indirect method. The direct method uses the cash activity recorded in the company's checkbook. Cash receipts and disbursements shown are totaled and classified in the three categories above. The more common, and more complicated, indirect method uses information gathered from the income statement and balance sheet.

Cash for investing and financing is calculated in the same manner under both methods, but the calculation of operating receipts and disbursements differs. Under the indirect method, the income statement must be adjusted for any noncash items and any changes in the business's current assets and liabilities, such as accounts receivable and accounts payable.

Regular analyses

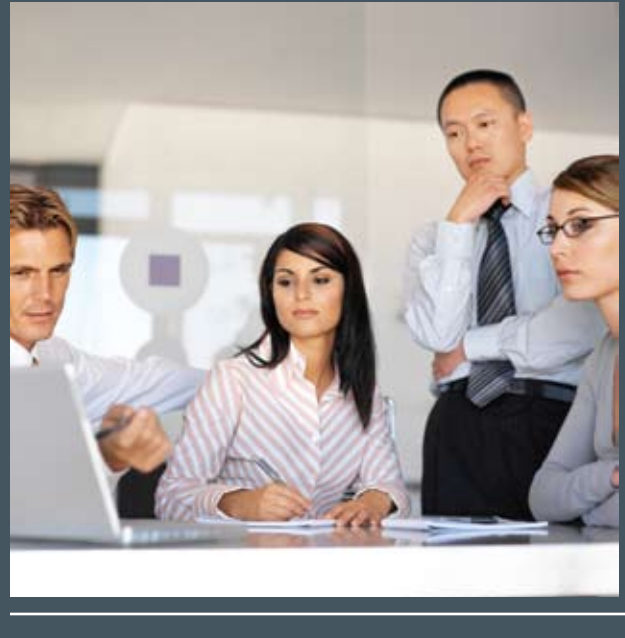
Even if a company is turning a profit, it can still go out of business if it's experiencing negative cash flow and unable to pay its bills. By regularly analyzing cash flow statements, you can pinpoint reasons for negative cash flow, such as poor collections or changes in fixed assets and debt. You can then begin to develop plans to remedy them by implementing ways to reduce your company's day-to-day operating expenses.

You might, for example, find it more cost effective to outsource certain areas of the business, such as

Cash flow ratios: Useful measures of success

You can plug data found on your cash flow statement into simple ratios to gain a better understanding of your company's financial condition. For example, if cash is critical to servicing long-term debt, then "cash flow to long-term debt" would be a useful ratio.

Using the "operating cash flow" ratio helps gauge your short-term liquidity by comparing the amount of cash generated to outstanding debt. This can help you understand how your current liabilities are covered by the cash flow generated by your company's operations, giving you a heads up on whether you'll be able to manage future loans, interest payments, payroll and other expenses.



human resources, payroll and benefits management, or information technology support. Or you might choose to implement inventory management agreements with suppliers that allow you to house inventory at their sites for longer periods, allowing you to save on storage and interest costs.

A holistic approach

Indeed, a cash flow statement provides you with information that's not easily extracted from an income statement or balance sheet, such as where your cash is and where it's being generated. But only by analyzing the components together along with other critical data can you understand your company's financial outlook and predict sunny skies ahead or a financial storm on the horizon. ■

A numbers game

Accurate inventory counts require diligence and commitment

Maintaining accurate inventory counts is a critical objective for distributors who wish to minimize costly errors and customer dissatisfaction. Do the counts in your inventory management system match what's actually stored in your warehouse?

If not, order fulfillment delays can result. Even though there is no quick-fix solution, diligence and commitment are keys to achieving accurate inventory counts. Let's take a look at a few specific solutions.

Cycle counting

Cycle counting involves taking a physical count of part of your inventory in the warehouse each day. These physical counts are then compared against the levels shown on your inventory management system.

By pinpointing inventory discrepancies, cycle counting helps you identify the source of accuracy problems, so you can implement applicable solutions. There are two types of cycle counting that distributors need to employ in combination:

- 1. Control group cycle counting.** This type of counting involves selecting a control group made up of a cross-section sample of inventory, including parts and materials, and then counting the control group and comparing it against your inventory management system data. If performed weekly (as recommended), control group cycle counting can help you identify the source of errors.
- 2. Random cycle counting.** After you've implemented control group cycle counting, identified any sources of inventory accuracy problems and put the necessary solutions in place, begin implementing random cycle counting. With this type of counting, you take a random mathematical sampling of your inventory to assess conformance with inventory accuracy expectations. An inference of the accuracy is then made relative to the entire inventory.

Cycle counting shouldn't be a one-time event. Conducted frequently, it will ensure continuing improvement in your inventory accuracy.

Process mapping

Of course, cycle counting isn't the only action you can take to improve inventory accuracy. For example, to gain a more comprehensive understanding of everything that affects your distribution company's inventory, consider mapping your processes.

To do so, chart the *actual* workflow and then document how these processes *should* work down to the individual task level for each position involved — from purchasing, receiving and stocking to order processing, fulfillment and shipping. This includes completing and processing paperwork, entering data through automated scanning techniques or manually at workstations, and performing any required monitoring checks for inventory.

Employee training

Set up training sessions for all your staff to review inventory processes and individual responsibilities. This will help them gain a solid understanding of workflow and how one process affects another.

Test your employees on their knowledge of and ability to perform expected tasks. Then provide constructive guidance for correcting errors. Consider customizing your training so new employees receive more extensive training while more experienced ones receive periodic refresher courses as processes change.

Continuous improvement

Regularly review your operations with your staff to pinpoint broken processes and identify solutions



for reducing errors. Doing so will allow you to incorporate enhancements or new processes as business needs change.

To avoid confusing employees with multiple process iterations, try to batch together several process improvements at one time. Then roll out the changes through formal training sessions to ensure everyone is on the same page.

Promote from within

Retrain low-skilled workers to enhance profitability

Manual jobs requiring only limited skills have been all but replaced by more complex positions involving high-tech automation, enhanced technology and data analysis. And as manufacturers explore additional ways to remain competitive in a difficult economy, some are branching out from their traditional roles to provide engineering, design and other related services.

As a result, many manufacturing jobs now require a higher level of education and advanced training. One solution that you shouldn't overlook can be found right under your plant's roof — your low-skilled workers.

Learning curve

To help your current employees increase their skill sets, start by developing position competencies so they'll know what functions they must master before they can advance in their jobs. Next, consider enrolling low-skilled workers with particularly good aptitude into specialized training programs addressing technical math, blueprint reading, practical dimensional inspection tools and machine technology.

From there, training might include learning manual machines such as mills, lathes and grinders. High-end training for exceptional workers can include learning CNC equipment, CAD/CAMS, mold polishing and design, and even robotics technology and maintenance.

In addition, enroll workers in workshops, online courses and certification classes to help keep them abreast of the latest processes, technologies and best practices. Encourage them to attend conferences so they can keep on top of new products and trends. The National

Correct counts = happier customers

In a challenging economic environment, keeping your current customers satisfied is an important goal. Maintaining accurate inventory levels goes a long way in achieving that goal. Why? Because order fulfillment delays can result in angry customers who may not be willing to give you a second chance. Implementing procedures now can pay off for your company in the long run. ■

Association of Manufacturers and other national industry organizations may be helpful resources.

To foster an environment for learning, encourage your managers to share knowledge with workers through informal workshops, one-on-one training and mentoring. Consider developing a formal cross-training program to help diversify employee skills and create more challenging work. This can also be beneficial when employees leave or are absent, terminated or laid off.

To foster an environment for learning, encourage your managers to share knowledge with workers through informal workshops, one-on-one training and mentoring.

Finally, be sure to reward employee growth and development with appropriate compensation and meaningful work that allows them to use their new skills. Both will provide them with a greater sense of value to the company and translate into greater job satisfaction and possibly even less turnover.

Lucrative returns?

Providing low-skilled workers with tools and resources to enhance their abilities is an investment in them *and* your company. The returns can be high: yielding more capable workers who could boost productivity and increase your bottom line. ■

What a private manufacturer should know about SOX

If you think the Sarbanes-Oxley Act (SOX) doesn't apply to your closely held manufacturing company, think again. Granted, you're *not* required by law to comply with SOX provisions — only publicly traded companies are held to its corporate governance and financial reporting standards. But many privately held companies are adopting some of the act's provisions because they make good business sense.

Sizing up the benefits

SOX created new standards for corporate accountability as well as new penalties for acts of wrongdoing. It changed how corporate board executives must interact with each other and with corporate auditors. And by holding CEOs and CFOs accountable for the accuracy of financial statements, the act made it virtually impossible for them to make the claim: "I wasn't aware of any financial issues."

Despite stringent regulations and the costs associated with compliance, the business world acknowledges that SOX represents some best practices.

Despite stringent regulations and the costs associated with compliance (additional paperwork and rigorous audits), the business world acknowledges that SOX represents some best practices, too. In fact, many companies insist that its customers be in compliance if they want to do business with them. For private companies, that may mean adopting some of SOX's provisions to allay pressure from banks, shareholders and customers to comply.

Some private companies will benefit more from implementing SOX provisions than others. For example, if you're planning to take your private manufacturing firm public, getting an early start on compliance — at



least a year in advance of SOX implementation — can help you avoid post-IPO costs and delays. And if you're considering a merger or acquisition with a public company, you're more likely to sell for a premium if you're SOX-compliant.

Most companies, however, can benefit from the stronger internal controls and fraud prevention policies that result from implementing SOX provisions. This, in turn, helps them attract viable board members and private equity investors and could enable manufacturing businesses like yours to more easily qualify for loans and competitive commercial insurance rates.

Picking and choosing provisions

Unlike public companies, a private company gets to decide which SOX provisions are best for it. Generally, private companies institute whistleblower policies, establish internal financial reporting controls, adopt corporate governance guidelines and require board approval for auditors to provide nonaudit-related services.

Here are several other SOX-friendly measures you can implement without paying the high costs of full compliance:

- Adding independent directors (not owners or managers) to your board,

- Forming an audit committee,
- Hiring an accounting firm to recommend audit improvements,
- Prohibiting or closely monitoring related-party transactions,
- Appointing a compensation committee to oversee executive compensation,
- Strengthening accounting procedures and record keeping, and
- Establishing procedures for employees to anonymously report any financial concerns, as well as the processes that will be used to investigate those reports.

Keep in mind that adopting these measures may not bring your business up to full SOX compliance, but they can strengthen your internal controls, credibility and company image.

Worth the investment

SOX encompasses more than just finance and accounting; it covers any activity that can affect your manufacturing company's financial well-being. Despite the costs of doing so, putting forth the effort to examine your facilities for potential SOX risks, address operational weaknesses that may affect your bottom line, and implement effective internal controls and independent oversight to protect your business from all forms of fraud can be well worth the investment. ■

Better safe than sorry

Conduct a safety audit to protect your employees and your bottom line

Accidents happen. Some are minor, but some can result in serious injuries and even death. Conducting routine safety audits and inspections can reduce workplace accidents by uncovering hazards and ensuring that workers are complying with your company's safety standards.

Recent information from the Bureau of Labor Statistics shows that 4 million nonfatal workplace-related injuries and illnesses were reported in 2007 — about half of which were more serious, involving days away, restrictions, and transfers (DART).

Such work-related accidents create financial burdens that can significantly hurt your company's profitability. In addition to workers' compensation claims, potentially higher insurance premiums and possible litigation costs, there are mounting indirect costs associated with an employee's time off. These include expenses related to:

- Lost production,
- Hiring and retraining new employees, and
- Management time spent investigating the accident and dealing with its aftermath, including low morale and answering to auditors and regulators.

The facts can be daunting, but there are steps you can take to protect your workers and, in turn, protect your company's bottom line. The best defense against injury and loss is an understanding of the risks and deficiencies within your operations. Here are two safety audits to help provide you with key information:

1. OSHA compliance audit. Auditors use a number of methods, including employee interviews and factory walk-throughs, to determine whether your facility and workers are adhering to safety standards and complying with federal safety regulations.

2. Safety management audit. This audit type measures the effectiveness of your company's safety management system. For example, if it's determined that employees aren't wearing safety goggles when they should, there's clearly an issue with your safety management system, which would then require a thorough review to pinpoint the problem and correct it.

Audits can be performed by professional and unbiased internal auditors or with the help of outside consultants.

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Our client base includes a broad range of businesses, including major concentrations of clients in manufacturing, distribution, construction, auto dealerships, healthcare, professional services and real estate. We enjoy close interaction with our clients and understand clearly that our true objective is to help the owners and managers of those businesses achieve their financial goals. Some of our customized service offerings for business owners include entity structuring to maximize tax benefits, management and family succession planning, and estate and trust planning. Our tax department includes over 50 dedicated tax professionals, with specialists in state and local tax, corporate and individual tax planning, estates and trusts, sales and use tax, and real estate cost segregation.

Our manufacturing services include:

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- Internal financial reporting
- Technology selection and implementation
- Business valuations
- Connecticut and multi-state sales and use tax issues
- Mergers and acquisitions
- Production and inventory control techniques
- Buy/Sell agreements
- Employee benefit plans
- Financial staffing

To learn more about our services, please contact:

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