Growth Rock News

December 2008

A manager's guide for building durable businesses with rock solid controls

Contents

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Growth Rock News is a monthly newsletter published by Anthill, a consulting firm that helps fast growing companies execute on growth strategies. Anthill works with companies to mitigate risks associated with rapid growth by building controls to improve profitability, cash flow and business credit.

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Are You Ready for the Year-end?

The year-end is approaching, and many companies are getting ready for the fiscal year close. For calendar year companies, a lot is riding on the December close. It’s one close that companies do not want to mess up.

The year-end financial statements will be used by people within and outside the company for various purposes in the next 12 months. Being detailed and thorough will help reduce work and expenses in the new year. Financial statements give management an opportunity to affirm their credibility with stakeholders for work during the past year.

Importance of Year-end Financial Statements

1. Reporting Obligations - Many companies and non-profit organizations must submit year-end financial statements (audited or not) to shareholders, creditors, donors and other stakeholders.

Certain investors need the information for their tax returns, such as preparing the K-1 schedule for a beneficiary's share of income/loss from partnerships and LLC's. If a company has shares listed on the US stock exchanges, it will need to issue audited financial statements to the SEC and other US regulatory agencies. For non-profits, donors annually review their funding programs to assess the effectiveness of contributions made in the past year.

Good financial statements can create a good impression and strengthen credibility with stakeholders.

2. Tax Filings - Probably the most important reason for having good financial statements is that companies need to do their tax returns. Tax filings at various levels depend on the year-end financial statements, including income, franchise and property taxes. Having accurate financial statements will save time and money. In addition, good financial statements will allow the company to take advantage of all deductions.

3. Annual Audits - Some companies are required to have an annual audit. Having good financial statements and workpapers will make audits go more smoothly, save staff time and audit fees. Also, clean audits look favorably on management, given audit results are generally reported to audit committees.

4. Year-end Bonuses - Companies may have management bonuses that are based on the annual financial performance. The last thing that a company wants to do is to revise a bonus of an executive because of an error in the year-end financial statements.

5. Raising Capital - Good financial statements will go far in helping companies raise money, whether a company is a for-profit or not-for-profit organization. Investors, banks, other financial institutions and donors will want to review financial statements before deciding to provide funding.

6. Obtaining Trade Credit - Companies are always out to obtain or improve credit terms with vendors. Before making a decision to grant or extend credit terms, trade vendors will want to review three pieces of information: 1) bank/vendor references, 2) third party credit reports, and 3) financial statements.

The accountant working on the fiscal year close is like a midwife delivering a baby. His job is to make sure the baby gets delivered in good health. Whether or not the baby is pretty is not his concern. Likewise the accountant is concerned that the year-end close goes smoothly and that the financial statements are delivered without material errors. There are a lot riding on the year-end close, so it's important to be thorough and meticulous.

(Continued on page 3)

Stop! Don't Throw Away Those Vendor Statements

Among the many issues a new company has to deal with, perhaps the hardest challenge is to establish credit. New companies seeking a bank loan or vendor trade credit will be scrutinized from the bottom up. Creditors will assess the four C's of credit: character, capacity, capital and conditions (or collateral). A fifth "C" that is overlooked is controls.

> **"As with any form of credit, trade credit must be earned and be built over time. Establishing trade credit is a painstaking process that starts with accounts payable controls."**

Trade credit is usually the most simple and most sought after form of credit, particularly for product-based companies. For such companies, establishing trade credit is a painstaking process that starts with accounts payable controls.

As with any form of credit, trade credit must be earned and be built over time. Trade vendors will generally require advance payments from new companies. Over time vendors may extend credit terms: from advance payment to due upon receipt to net 15 days to net 30 days, and so on. Vendors generally will offer improved terms to customers who have shown a history of prompt payments. Thus, it is essential that a company establish vigilant accounts payable controls. Verifying both the completeness and accuracy of vendor invoices is important to maintain trust and build trade credit.

A vendor statement is a valuable piece of information. Not to be confused with a vendor invoice, the vendor statement is a summary listing of all invoices outstanding. It is generally sent by vendors as a reminder to pay. Unfortunately, many companies receive statements in the mail and toss them in the wastebasket. Reconciling vendor statements is something that should be done regularly, particularly for key vendors.

Reconciling statements is important for several reasons:

1. Account for missing invoices. Retail and wholesale companies handle a high volume of invoices. For these companies, there is bound to be invoices missing in a given month. Invoices can get lost in the mail or on someone's desk buried under a mound of paperwork. Accounting for all invoices is important for several reasons:

(a) State financial statements correctly.

(b) Age accounts properly so that invoices can be paid on time.

(c) Take advantage of any cash discounts within the period allotted.

2. Verify the accuracy of invoices already entered for amounts and aging. Due to the volume of invoices processed, there is a risk that amounts and due dates were entered incorrectly.

3. Identify discounts or adjustments that the company has not recorded. Often discounts are not communicated to accounting. Credit memos may be routed to people outside accounting.

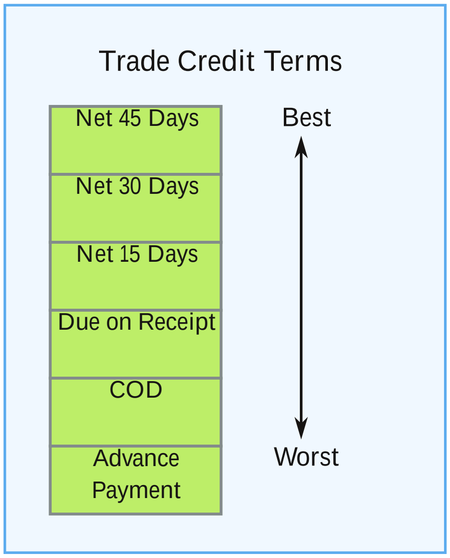
4. Protect the company's credit score. Poor controls can be costly. A company's credit rating is based on its ability to pay vendors promptly. If invoices never get entered or entered incorrectly, the company's trade credit may be at risk if the vendor reports to credit rating agencies, such as Dun & Bradstreet. Being consistently late with payments by a few days can result in a lower credit score. A poor credit score will penalize a company when it applies for credit with banks or other trade vendors.

5. Allow companies to have regular contact with vendors. Having ongoing communication with vendors helps to establish rapport and gives assurance that their invoices are being attended to. In cases when a company is late because of a missing invoice, vendors will be more accommodating. Also, vendors can provide information about new products, promotions and special pricing.

Collections Notices & Vendor Litigation

It is important that companies pay attention to collections notices in the mail. These are pesky letters from third party collections agencies or collections attorneys. Companies should follow up to determine the nature of the notice. Many times notices relate to a predecessor company that went bankrupt, the debts of which are still in the name of the surviving company.

By confusion delinquent payments may be reported to banks and third party agencies, which use the information as part of their overall credit score. It is imperative that companies address these notices and clear up incorrect information.



If managed carefully, trade credit can be a valuable resource for growing companies. Trade credit can be built by having good controls. Such controls do not require significant investment in time or money. Simple procedures, such as reconciling vendor statements monthly, can go a long way in obtaining zero-cost financing that improves cash flow.

—GRN 12/08

Are You Ready...

(Cont'd from page one)

Year-end Close Checklist

Discussion of the mechanics of the month-end close is beyond the scope of this article; however, there are things that accountants should keep in mind when doing the year-end close. The following checklist serves as a guide and is not intended to be an exhaustive list. Companies in specialized industries will have additional procedures to consider.

—GRN 12/08

Area	Reminder
Cash	- Review stale dated checks on the outstanding check list and follow up with payees; if necessary, write-off anything that is old - Close inactive bank accounts
Accounts Receivable	- Review aging and follow up with customers to collect on as many past due accounts as possible - Review collectibility of all unpaid accounts. Write-off accounts deemed uncollectible - Assess adequacy of reserves and make appropriate provisions
Inventory	- Conduct physical inventory and coordinate with auditors - Reconcile physical inventory to perpetual and G/L records - Review slow moving and obsolete inventory to assess whether write-offs are needed - Assess adequacy of reserves and make appropriate provisions
Fixed Assets	- Conduct physical inventory of fixed assets; tag assets - Reconcile physical fixed assets with subledger and G/L records - Record all depreciation entries for the year - Revise useful life of assets that may be impaired (damaged) - Write-off fully depreciated assets no longer in use
Goodwill/ Intangible Assets	- Review goodwill and intangible assets for impairment - If necessary adjust useful life of asset or write-off balance completely
Accounts Payable	- Post all vendor invoices - Reconcile vendor balances against vendor statements, particularly for large vendors - Obtain tax ID and address (W-9) for all independent contractors for 1099 reporting - Ask employees to submit all travel & entertainment expenses (T&E reports) for 2008, including any mileage deductions

Accrued Expenses	- Estimate unbilled expenses through 12/31, particularly for the following
	  - professional fees (accounting, legal, consulting)
	  - product merchandise received

Contingent Liabilities	- Review for contingent liabilities, such as litigation, product warranty, sales returns, incurred but not reported medical costs (self-insured plans) and environmental cleanup costs. Contingent liabilities should be recorded if they are probable and can be reasonably estimated.
Payroll/Benefits	- Obtain address and social security number (W-4) for all employees to send W-2 forms - Remind employees about the flexible spending accounts (FSA) use-it-or-lose-it deadline - Consider making IRA or 401k contributions to reduce taxable income - Remit employee IRA or 401k contributions withheld to trust account - Accrue for year-end payroll, if necessary
Other	- Consider making year-end charitable contributions to reduce taxable income (cash or donated assets)

Accounting System/Software	- Download tax updates (payroll and sales taxes)
	- Close prior periods in system
	- Review security controls and update users and passwords
	- Make data backups
	- Clean up vendor, customer and employee masterfile data
	  - De-activate vendor, customer and employee records with no activity during the past 12 months
	  - Combine duplicate records
	  - Verify completeness of records (name, address, tax ID, etc.)

Get Physical with Fixed Assets

Taking a physical count of fixed assets is something that companies do once in a blue moon. Like other tangible assets, fixed assets should be verified periodically. It is recommended that a physical count be done once a year.

The physical count is similar to a physical inventory of merchandise products, except that there are probably much fewer items. Another difference is that fixed assets can be found anywhere in the company. Companies generally do not track the location of fixed assets like they do for product inventory. The third difference is that while companies usually take a physical count of their merchandise inventory once a year, they seldom take a physical count of fixed assets. The infrequency in doing one makes the task difficult if record-keeping is poor.

> "Making large unplanned capital expenditures because of poor record-keeping can be potentially disastrous."

There are several reasons to take a physical count of fixed assets:

1. Find where fixed assets are located. Fixed assets often get moved around. It is easy to lose track of where an asset is located. Second, assets go missing or get stolen. Small portable assets, such as computers and office equipment, are susceptible to theft. Also, a count will identify employees who have been hoarding assets. It's not unusual to find employees with multiple computers and faxes that can be used elsewhere.
2. Tag fixed assets. Tagging with a bar code or another identifier establishes the company's ownership and wards off theft. If a company buys and leases assets, tagging will help distinguish between the two groups of assets and will make the job of returning leased assets to the owner much easier.
3. Ascertain useful life of assets. Certain assets, such as production machinery and equipment are used intensively. Their estimated useful life may need to be adjusted based on the condition of the asset, and depreciation adjusted accordingly. If the asset is damaged or permanently impaired, the company should write it off the books to maximize tax deductions in the current year.
4. Identify idle or unused assets. Idle or unused assets can be re-deployed, sold or donated. For example, a company can save money by putting to use an idle computer, instead of buying a new one. Similarly, a company can sell or donate idle or unused assets to generate cash, receive a tax deduction or save on property taxes. Disposing certain assets will also help free up storage space.
5. Improve capacity planning. Assessing condition will help companies identify over and under-utilized assets, such as machinery and equipment for capacity planning. Maintaining good usage records will help companies deploy assets within the manufacturer's specifications to optimize capacity utilization. Doing so will help extend the useful life and avoid wear and tear that result in higher maintenance and repair (M&E) costs. Capacity analysis will give managers a good picture of M&R costs needed for the new year, control costs, increase productivity and maximize profits.
6. Improve cash flow planning. Knowing what the company has and the overall condition of the asset will give operating managers an idea of the capital expenditures needed in the new year.

As the year-end approaches, managers should do a physical count of fixed assets. Getting a grip on fixed assets is essential to manage cash flow. Capital expenditures are usually significant. Making large unplanned expenditures because of poor record-keeping can be potentially disastrous for a fast growing company.

—GRN 12/08

DSO Primer

Do you know what your DSO figure is? To the uninitiated, DSO sounds like a government bureau. In the world of accounting, DSO stands for Days Sales Outstanding. DSO is an important cash flow and liquidity number used to measure how quickly the company collects on credit sales. DSO is a key component of operating cash flow.

DSO is measured in days and is computed as follows:

> DSO = accounts receivables/credit sales per day.

Companies should think of DSO like playing golf - the lower the score the better the performance. Cash flow improves as DSO is smaller. In other words, cash flow improves when the accounts receivables balance declines. DSO can be calculated for any period of time, yearly, monthly or weekly. The receivables and sales figures need to be adjusted to cover the reporting time frame. For example, if a company is computing DSO for the month, it would calculate the average accounts receivable and sales only for the month.

Like any other metric, DSO should be monitored over time to identify a trend. A company wants to be sure DSO is within its credit policy. That is, if a company generally offers net 30 days terms to customers, DSO should not be too far off. It is also useful to benchmark DSO against that of comparable companies within the same industry.

Deterioration in DSO over time can signal problems in billing or collections and create cash flow problems. If left unattended, the problem can lead to insolvency.

—GRN 12/08

Accounting Calendar
December 2008

Sunday	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday
	1 Form 730 and tax due on wagers accepted in October Form 2290 and tax due for vehicles first used in October	2	3	4	5	6
7	8	9	10 Deadline to report employee tips of $20 or more for Nov	11	12	13
14	15 Corporations: Q4 estimated income taxes due	16	17	18	19	20
21	22	23	24	25 Christmas Day	26	27
28	29	30	31 Form 730 and tax due on wagers accepted in Nov Form 2290 and tax due for vehicles first used in Nov			