

Trendlines



New Directions in Business and Personal Planning

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Plus!

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Ready, set, sell!

How to prepare for an unexpected business sale

Like many business owners, you probably have some idea of how and when you'd like to exit your business. Although the handoff you envision may occur as planned, you should also consider the possibility that unexpected circumstances — death, divorce, illness, financial hardship or even a great buyout offer — might force a sale.

Let's say you had to sell your company tomorrow. Would you know how to ensure your business looks its best for prospective buyers? Read on for some helpful tips on this challenging task.

Everyone needs advisors

Before you do anything, enlist the help of your CPA, attorney and any other advisors you feel will help. They can, among other services, help you formulate a strategy to sell or liquidate the business, identify and perform due diligence on potential buyers, and assist you in drawing up confidentiality agreements. And even if a sale isn't imminent, consider having your CPA review your operations periodically with an eye toward helping you capitalize on your company's strengths and address its weaknesses.

You'll also need a business valuation. For more on this process, see "Your business: What's it worth to you (or anyone else)?" on page 3.

Clarity leads to confidence

Impeccable financial statements are hard to argue with. So the better your records, the more credibility you'll have as a seller and the harder it will be for prospective buyers to work down your price.

Ensure important data — such as accounts receivable; working capital; cost of goods sold; inventory turns;

and earnings before interest, taxes, depreciation and amortization (EBITDA) — is reliable. Organize it in a way that helps buyers understand your business's true profitability and financial condition — not just your bottom line.



Buyers also like to see evidence of consistent accounting practices, so reconcile key general ledger accounts such as cash, receivables, inventory and accounts payable *promptly* each month. Otherwise, significant fluctuations in gross profit margins and other key financial measures may not be detected.

If possible, show interested parties audited financial statements for at least the three years before a potential sale. This will give them a good perspective on how well you've managed your company during this period.

Simplicity breeds success

Many closely held businesses have significant nonessential expenses on their books. These often include unusually generous officer compensation, employee benefits, luxury cars, and high travel and entertainment costs. You may want to flag these discretionary costs in your books so potential buyers can easily see where they could cut expenses.

Similarly, consider paring inventory to boost profits as you march toward the sale block. Anything you can do to strengthen your negotiating position and prevent buyers from using an obscured cash-flow picture against you will help maximize your sale price.

Words have meaning

Another common aspect of many closely held businesses is that important operational information resides only in the heads of key employees. Prospective buyers will feel more comfortable if you put your policies and practices in writing. Document items such as:

- ☞ Vendor payment terms,
- ☞ Employee benefits,
- ☞ Marketing strategies,
- ☞ Training techniques, and
- ☞ Billing and collection procedures.

By writing down your company's working knowledge, you'll increase the value of your business and promote an orderly transition.

Relationships require attention

A current owner can more easily initiate or renew contracts than someone new could. So try to solidify relationships with key customers and suppliers. Doing so will assure potential buyers of your company's continued prospects.

For instance, if you have a verbal agreement for exclusive territorial rights to a product, formalize the arrangement with a contract. And try to strike similar agreements with long-term customers who currently aren't under contract.

In addition, examine and renegotiate leases for facilities and equipment so they don't increase or expire just as you're ready to sell. Safeguard any proprietary processes or patents you may have, too.

Teamwork is essential

If you want your company to retain its value — with or without you — put an experienced management team in place, or at least groom a general manager to

Your business: What's it worth to you (or anyone else)?

Even valuation professionals acknowledge that you don't really know what your business is worth until you actually sell it. Nonetheless, valuers typically apply one or more of these three methods to establish value:

1. The income approach, which is based primarily on the company's earnings,
2. The market approach, which compares sales of similar businesses, and
3. The asset approach, which looks at the fair market value of the company's assets.

Service businesses with strong income histories but few tangible assets are good candidates for the income approach. On the other hand, the market approach might favor companies in industries that command consistently high sale prices because of their economic stability or other factors. Then again, the asset approach would more likely fit a company with substantial hard assets but weak revenues.

Of course, other valuation considerations apply as well. Marketability, minority interest or premium factors may play a role. And goodwill and other intangible assets, such as patents and trademarks, can be difficult to value. Even tangible assets, such as real estate, are often undervalued.

For these reasons, short of simply selling your business and seeing what you can get, the best way to establish a realistic and objective value is to obtain a professional valuation. And a business sale isn't the only reason to do so — you should also consider a valuation when seeking loans, establishing an employee stock option plan, creating a buy-sell agreement or engaging in estate planning.

replace you, before going to market. You'll enhance your ability to sell and ensure a smooth transition.

As you transfer responsibility to others, make sure your customers, suppliers and bankers get to know these people and develop confidence in their ability to continue your business.

Anything can happen

Whether or not you anticipate selling your business anytime soon, stay on guard. A sudden misfortune — or even a great opportunity — may drive you to sell unexpectedly. Keeping your company perennially attractive to potential buyers will boost your chances of getting top dollar should you need to sell and will strengthen your company anyway if you don't. ☐



As the money turns ... so does your success

6 cash-flow boosters for your business

It's no wonder cash flow is often called the lifeblood of a business. Even a wildly profitable company can't survive unless it systematically converts sales into cash. But unlike some problems that bedevil businesses, cash-flow issues can usually be rectified.



Essentially, good cash management boils down to answering a few simple-to-ask but tricky-to-solve questions: How can you get paid faster? How can you pay others under more favorable terms? And how can you do more with the money you have? Here are six cash-flow boosters that can go a long way toward unraveling these riddles.

1. Establish payment expectations

The best time to inform customers and prospects about your rates, billing practices, and credit and payment terms is when you first deliver a proposal, estimate or contract. Put your expectations in writing and review them with the customer or prospect. Cover points such as when you expect payment, what incentives you offer for paying early or using a preferred method, and how you deal with delinquent accounts (such as by assessing penalties or interest).

This approach helps ensure that no surprises occur on either end at billing time. For instance, if you discover that a customer's payment policies conflict with yours — maybe your company requires payment on delivery and the prospective customer pays in “net 30 days” — you can work out the differences before you shake hands on the deal.

2. Improve customer payment terms

If more cash is flowing out than in, your accounts receivable practices probably need some attention. Start by analyzing how customers pay you (typical options are by check, automatic credit-card payment, bank debit or electronic funds transfer) and under what terms (examples include per order, quarterly or on an annual prepayment plan). Your goal should be to get as many customers as possible paying in a way that is most beneficial to you.

If you can convince customers to prepay annually or to agree to pay automatically, you'll get their money sooner.

For example, suppose about one-third of your customers pay quarterly by check. You must not only spend time and money sending quarterly statements, but also wait for payment. If you can convince these customers to prepay annually (by offering them a discounted price, of course) or to agree to pay automatically, you'll get their money sooner. More important,

you'll lock in these relationships for specified periods and be able to immediately put the cash to work in your business.

Depending on the nature of your company, you may even be able to establish a one-size-fits-all payment plan. For instance, some membership-based businesses, such as health clubs, require customers to pay by automatic credit-card billing either annually or monthly.

3. Stay on top of accounts receivable

Closely monitor accounts receivable aging and develop a system for following up on overdue accounts. If a customer isn't paying on time, you need to investigate why.

Perhaps it just overlooked your invoice. Or it could be dissatisfied with your product or service. Maybe the customer even complained to someone at your company, but no follow-up occurred. Another possibility is that the customer simply has questions about the bill. By following up on overdue payments promptly, you can learn more about your customers — including information that may keep you from losing them.

You might also try improving collections by linking employee compensation to specific performance targets. For instance, offer accounts receivable staff cash bonuses or other incentives if a certain percentage of receivables arrive in less than 30 days.

Similarly, make sure your sales force understands the importance of gathering proper credit information and communicating payment policies. Salespeople are usually more attentive to these issues when their compensation depends on their accounts paying in full.



4. Negotiate better vendor terms

Suppliers appreciate customers who pay promptly and consistently. They also appreciate customers who will agree to mutually beneficial payment terms. If your company falls into both of these categories, consider asking suppliers for longer credit periods, increased limits, prompt-payment discounts and more convenient due dates.

But, first, do some research. Find out how quickly you typically pay, the volume you do with each supplier and your industry's payment norms. You'll be more persuasive if you can cite specific numbers.

On the other hand, check that you're not paying vendors *too* fast. If you have 30 days to pay a supplier, don't pay in 10 — unless you receive a worthwhile discount for doing so. And though you want to delay payment as long as possible, be careful not to incur any late charges or penalties. These will only hinder your negotiating power.

5. Put technology on your side

Good technology will allow you to spend more time working *in* your business than *on* it. For example, software that performs various cash-flow analyses, including daily accounts receivable aging, is essential — and inexpensive.

Besides software, consider using e-mail to improve your cash flow. Some customers may agree to electronic invoicing, which may shorten the payment cycle.

6. Hire a watchful eye

If your business is growing rapidly, your time is probably best spent dealing with customers and managing day-to-day affairs. But because someone needs to stay focused on cash flow, consider hiring a skilled financial professional whose duties go beyond routine record keeping.

This person may be a CFO, controller or even an outside accountant who provides consulting services. Ideally, you'll want someone with the time and talent

to design strategies for putting every available dollar to work either covering payments or producing income.

Attain the profit glow

You need not micromanage your cash flow to be successful. In fact, doing so may lead to penny pinching that slows growth and lowers employee morale because of excessive rules and red tape.



But you do need to monitor your cash flow. By keeping the dollars pumping through your company's veins, you'll attain that rosy "profit glow" that makes you the envy of your competitors. □



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Download tax savings with VoIP. Many businesses may soon be able to make telephone calls over the Internet. It's nothing new, just a fresh incarnation of a neglected service — called VoIP — which should be available in 100 markets by year end and integrated with cell phones by 2006. By using it, you may be able to not only cut telecom costs, but also lower your tax bill. That's because the government currently treats VoIP as a nontaxable "information service," even though it taxes conventional calls.

Need to save for a college education? Go shopping. The Web site www.upromise.com allows you to earn rebates of up to 10% when you buy certain products. You simply register your supermarket-loyalty card or credit card and then accumulate funds in your account as you shop. (Friends and family members can contribute, too.) More than 18,000 grocery and drug stores; 50,000 other stores, services and restaurants; and 200 online retailers are participating. Among other actions, you can regularly shift savings into a Vanguard 529 college-savings plan where they'll grow tax free.

Aches and pains may lead to productivity drain. Does an employee's sore back or nagging arthritis really affect your bottom line? Yes, says a 2003 study published in the *Journal of the American Medical Association*. It found that "common pain conditions" cost employers \$61.2 billion in reduced productivity and diminished functioning annually. What can you do? Well, you obviously can't read workers' minds and tell them to get help, but you can promote a healthful work environment and encourage employees to use their medical benefits.

Tax breaks ease unemployment woes. If you've been out of work for any part of the year, take heart: Uncle Sam grants tax breaks for job-search-related costs. As long as you limit your search to your current field, you may itemize expenses such as phone calls, resume preparation and even charges for online career assistance. If you've beefed up your skills with new education (again, in your current field), these costs are generally deductible, too. Finally, if you move more than 50 miles to another city to accept a new job, you can take an above-the-line deduction for the relocation expenses.



Heed the details of special needs trusts

Oscar and Jolene have an 8-year-old son, Jeffie, who was born with spina bifida. Naturally, Oscar and Jolene want to ensure Jeffie is financially secure after they're gone. And they don't want to risk losing the government funds they now receive for Jeffie's ongoing medical care. Wisely, the couple brings the matter to their financial advisor.

Generally, the advisor explains, a disabled person cannot inherit more than \$2,000 without interrupting his or her Supplemental Security Income (SSI) and Medicaid benefits. (Other Social Security benefits are not based on one's assets or income.) It's also important to note that states are allowed to have their own, stricter qualifying criteria for Medicaid. For instance, one could qualify for SSI but not Medicaid.

Fortunately, no matter where they live, Oscar and Jolene can bequeath their estate and keep the aid flowing with a special needs trust (called "supplemental needs trusts" in some states). These arrangements allow trustees to disburse funds for a beneficiary's supplemental needs — that is, whatever isn't covered by government benefits.



The most common option

These arrangements fall into three categories: family trusts, pooled trusts and court-ordered trusts. Oscar and Jolene probably need the first option, the family trust, which is also the most common.

They could set up an inter vivos trust, meaning they could set aside the money immediately. But funding the trust during their lifetimes could trigger tax liability. Another option is to have the trust funded after Oscar and Jolene die. In either case, relatives could direct Jeffie's share of their estate to his trust through a special provision in their own estate plans.

This trust type does have limits. The funds can't be used for housing, food or clothing, because the government considers these basic

needs. Nor can trust funds be distributed directly to Jeffie, which could disqualify him from government benefits.

2 other choices

Oscar and Jolene may consider a "pooled trust" as well. Here, anyone, including the beneficiary, can contribute funds, though the trust must be set up through a nonprofit association. That organization combines the assets with those of other participants and the beneficiary receives the money on a pro rata basis. The nonprofit also prepares the tax returns, makes investment decisions and serves as trustee.

In a pooled setting, fees and administrative costs go down, but funds remaining in the trust after the beneficiary dies may revert to the trust's pool to help other participants. Whether they do depends on the nature of the trust. Some pooled trusts allow the beneficiary to designate to whom any remaining funds pass — but only after the state is reimbursed for benefits it paid out to the beneficiary during his or her life.

Court-ordered (or "Type A") trusts don't pertain to Oscar and Jolene's situation but do in other circumstances — such as when the disabled person has inherited money or received a court settlement. In these cases, the beneficiary actually owns the money.

Only the disabled person's parent, grandparent, legal guardian or a court can set up this trust type. To qualify, the disabled person must be under 65 years old and meet Social Security disability standards. In addition, these trusts have the same "payback" requirement as pooled arrangements: The state is first entitled to reimbursement for benefits it paid out during the beneficiary's life.

An important vehicle

The special needs trust is an important estate planning vehicle for parents of disabled children. And Oscar and Jolene were wise to go to their advisor about this arrangement. Because laws and regulations regarding special needs trusts vary by state, it's critical to consult a *local* professional familiar with government benefits and special needs planning. □



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