Perspective

Second Quarter 2009

Practical ideas for manufacturers and distributors

5 steps for managing your company during turbulent economic times

The effects of the current turmoil in the global financial system will be felt for years to come. Initially the fallout affected primarily companies in the mortgage and financial services industries, but it is now touching the lives of virtually every tax-paying American citizen.

While the current credit crunch has its roots in the subprime mortgage crisis, it has extended far beyond traditional lending institutions, spreading its tentacles to financial firms like Lehman Brothers and Bear Stearns as well as insurance companies such as American International Group. Whether and to what extent the various government interventions attempted will ameliorate the crisis remains to be seen.

These tough economic times require that you have a solid understanding of your company's position within the bigger economic picture. Not all industries are affected equally by a recession. The cyclical volatility of differing sectors varies widely. In general, durable goods industries are affected more greatly than nondurable goods. But even within those sectors, results vary. Understanding your industry's position within this picture is vital.

Understanding your industry's volatility is only the beginning. You also have to determine how best to manage your business. The following are some key strategies to consider:

Step 1. Analyze your entire operation. Take a serious look weekly, even daily, at the demand and the costs. This more detailed look at your cash flow, income statement and balance sheet will enable to stay one step ahead of your operations and will prepare you for what issues need your immediate attention.

Some company owners have a tendency to think they can grow their way out of debt. Management will forecast an increase in sales or new product launches as a turnaround strategy. It is, however, almost unheard of for a company to grow its way out of problems. Product launches or other growth strategies generally require significant upfront investment, with projected revenue increases lagging behind. For a company already experiencing liquidity issues, such strategies will exacerbate, not help, their problems.

Step 2. Determine if there are sufficient resources to achieve forecasts, taking into account unexpected surprises. If there is an inability to fund operations or if there are projected deficits, look at making changes to stabilize the company. Look for the core business and jettison non-core assets or lines of business.

The restructuring specialist may also have to break through a logjam of denial. The company may have never had liquidity issues, and management may not understand how serious a liquidity crisis can be to the company's operations. Management may also be blinded by a feeling that it can resolve the situation by itself without seeking outside assistance. In either case, whether management is driven by arrogance or by denial, a company will need operational restructuring to get back on its feet.

Step 3. Look at credit terms. Which creditors have been overextended? Figure out a process to deal with them. Rank payments to determine the necessary cash outflow. Stick to reasonable credit terms and monitor them properly.

Step 4. Develop a plan to deal with customers and suppliers. Assure your customers, if you're able to, of your ability to continue to supply them with goods. Look at contracts with your suppliers. Which are sole-source suppliers? If they fail, they can disrupt the balance of your supply chain. Develop a plan to procure the goods necessary to meet your needs and continue the flow of liquidity.

Step 5. Communicate with your stakeholders—your lenders, customers, vendors, suppliers, employees and board of directors. This may involve meetings and phone calls, as well as written communications regarding the company's status. Inform your stakeholders that you're embarking on a

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401(k) Challenges in Troubled Economic Times

In these troubled economic times, it is vital that companies pay close attention to the proper operation of sponsored 401(k) plans. The need for close attention to the plan is especially important now because troubled economic times and difficult investment markets are affecting almost all 401(k) plans. We have outlined seven important steps you can take to minimize the risk of costly financial consequences relating to your 401(k) plan's investments, contributions, compliance testing and in-house operations.

1. Review your plan's investment options from a fiduciary perspective.

- Make sure your plan has an Investment Policy Statement that lists your criteria for selecting and monitoring the menu of investment options offered to participants. This is a crucial part of protecting the employer and trustees from fiduciary liability for investment losses incurred by participants during this declining market.
- Manage the plan's investments in a manner that provides maximum fiduciary protection for the employer and the trustees under ERISA Sec. 404(c).

2. Review the affordability of employer contributions under your plan.

- Look at your budget to see if you can afford the level of employer contributions (matching and/or profit sharing) that are either specified in your plan document or that your employees are expecting to receive.
- If your plan has a fixed contribution rate stated in the plan document, you must consider your company's ability to fund the required cost. If you are uncertain about your ability to meet that obligation this year, discuss with your plan advisors what options you have to reduce, suspend, or eliminate the required contribution.

3. Consider the effect of contribution changes on your plan's annual compliance tests.

- If you reduce or suspend the employer matching contribution, some employees may reduce or suspend their salary deferrals. Lower salary deferral participation by non-highly compensated employees (NHCEs) may make the plan fail the ADP and/or ACP tests that limit salary deferrals or matching contributions for highly compensated employees (HCEs).
- If you reduce or suspend a safe harbor matching contribution during the year, the plan will lose its safe harbor status for the entire year and must be subject to ADP and ACP testing that year.
- If your plan is a top-heavy plan (a plan in which 60% of more of the benefits belong to owners or certain officers of the business), any salary deferral contributions made by owners or officers of the company during the year could trigger a mandatory top-heavy minimum employer contribution for that year.

4. Maintain timely deposits of employee salary deferrals.

- Do not be tempted to delay the deposit of your employees' salary deferrals (and/or loan payments) when cash flow is tight. U.S. Department of Labor regulations require these amounts be deposited into the plan as soon as administratively possible after the date they are withheld from payroll.
- Late deposits of employees' deferrals and/or loan payments must be reported to the Department of Labor on the annual Form 5500 and will subject your company to penalties as well as the cost of restoring lost earnings to affected participants' accounts.

5. Expect more frequent requests for plan loans and/or hardship withdrawals.

- Due to the severe effect of the economy on many individuals and their families, more participants than usual may be requesting loans or hardship withdrawals from your plan.
- Some employees may stop making their loan repayments to the plan and default on the remaining loan balance. These loan defaults must be reported to the IRS as a deemed taxable distribution from the plan to the employee. You must notify your plan service providers whenever a loan default occurs, so they can prepare the necessary Form 1099-R that year.

6. Watch out for special vesting rules that can be triggered by layoffs.

- If your company lays off a significant portion of the employees eligible to participate in the 401(k) plan, the plan would be treated as having had a "partial termination", which would result in the laid-off employees becoming 100% vested under the plan. Generally, a layoff of at least 20% of eligible plan participants during one year would be treated as a partial termination.

7. Establish a policy for interim valuations of any pooled investment accounts.

- If your 401(k) plan has any pooled accounts that are not valued on a daily basis at the participant level, consider establishing a policy to determine the circumstances the plan would automatically require an interim valuation of the pooled account before paying out benefits to terminated participants.

To learn more about how you can maximize your plan design contact us at 888.RET.401K or visit us online at www.rsmmcgladrey.com.

Significant changes created by Statement 141R

As a result of a recently issued standard by the Financial Accounting Standards Board (FASB)—FASB Statement No. 141 (revised 2007), Business Combinations—a number of changes may give acquiring businesses more than they bargained for, if they close the deal in 2009 or later. While the modifications to business combination accounting are signs of the industry's move toward increasing the usage of a fair value model, as well as further alignment with International Financial Reporting Standards, some of the revisions are significant and are considered by some to be controversial.

These are a few of the most significant changes created by Statement 141R, but the standard's many revisions will affect business combinations in different ways.

- All assets and liabilities of the target are required to be recognized and measured—even those in a partial acquisition.
- The use of a "fair value" model, rather than a "cost allocation" model will be used to measure assets acquired and liabilities assumed. Further, Statement 141R uses the fair value model rather than a "carryover basis" or "book value" model to determine the non-acquired (or non-controlling) interest in the target.
- Deal costs incurred by the buyer are no longer included in the purchase price of the target when accounting for a business combination.
- The new guidance now distinguishes between contingencies of the target that are contractual and non-contractual.
- The recognition of the fair value of earn-outs (i.e., contingent consideration) in the initial accounting for the acquisition.
- The elimination of the recognition of liabilities for restructuring costs expected to be incurred since they do not represent a liability as defined in Concepts Statement 6.
- The reduction of the valuation allowance in income tax expense, if a buyer determines some or all of its previously recognized valuation allowance is no longer needed as a result of the business combination.
- The recognition of a gain from a bargain purchase—if applying Statement 141R results in negative goodwill, the buyer is required to perform a review of the factors; if negative goodwill still exists, the buyer recognizes a gain from a bargain purchase.

The new standard is effective for business combinations with acquisition dates that occur on or after the beginning of the first annual reporting period of the fiscal year beginning on or after December 15, 2008. For calendar year companies, the standard is applicable to business combinations with acquisition dates of January 1, 2009, or later.

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restructuring process and share the timetable. Allow them to understand the situation, your needs, and your course of action.

Clearly your employees are among your key stakeholders. You need to develop a process that not only informs them of the status of the company but also empowers them to help implement a restructuring plan. Although it is not always feasible to communicate all the details of the restructuring to your employees, it is important to keep your key people informed and communicate to them what their new roles will be.

No matter which strategies are appropriate, it is vital to plan and act aggressively to anticipate and address issues before they get out of hand. As you look at your budgets and projections, stress test them severely. What happens if sales that you anticipate to be flat are actually off by 10 percent? By 20 percent? Having a plan in place in advance to deal with each eventuality will enable you to react in real time to your circumstances in an environment where the ability to move quickly is vital.

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