

SPRING 2010

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Are you getting paid?

Managing collections in an uncertain economy

The economic uncertainties facing many businesses today have put them in an odd position. Should they push customers harder for payments? Or go easy on them to avoid risking the loss of their business?

It's a tricky balance and, interestingly enough, attaining it may have more to do with you than your customers. Why? The better you know your own collection rate and the more you refine your collection practices, the greater your odds for success.

Calculate your collection rate

You may feel your collections are going badly but, until you put a number to what's going on, you'll likely find it difficult to fix anything. To better understand your collection rate, you must determine your business's accounts receivable (AR) turnover ratio.

Start by writing down your beginning and ending AR amounts for your last business year. Then add these two amounts and divide by two — this is your accounts receivable average (ARA). Finally, divide your annual net sales (noncash sales less returns and allowances) by your ARA to obtain your collection rate.

Clearly, this number alone won't tell you much. You also need to compare it with those of other similar businesses. To do so, ask your CPA if he or she has any benchmarking reports for businesses like yours. And, if you belong to any trade associations, ask if they generate this type of information.

Along with knowing your collection rate, be sure you're constantly aware of the status of your receivables in total as well as how regularly each customer is paying you. Do this by frequent monitoring of AR aging schedules, with particular emphasis on amounts that are beyond normal payment terms.



Reassess your payment terms

What adjustments to your collection process should you consider? To get the brainstorming started, look at how customers pay you. What percentage of your payments come via check, credit card, bank debit and electronic funds transfer? Then examine your typical terms of payment by breaking this data into categories, such as per order; once per month payments from statements; and monthly, quarterly and annual prepayments. The objective here is to align as many customers as possible to methods and terms that best fit your company.

For instance, say roughly 25% of your customers make quarterly payments by check. That means your staff is spending a lot of time (and your money) generating quarterly statements and processing these paper-based payments. By converting these customers to annual prepayors (those who prepay annually) or automatic payors (those

who pay automatically), you'll get their money sooner and with less labor time.

Naturally, pulling off such a feat is easier said than done. Discounts or special sale prices can help you make your case as to why customers should sign up for annual prepayments. The nature of your work, however, may prevent this option. Product-oriented businesses usually can't collect in advance of providing the product.

Create a collection plan

With your payment system realigned, it's time to turn back to collections. Often, simply breaking down the collection process into a clear timeline can improve a company's ability to cope with AR problems. Assuming your terms are net 30 days, you might break it into six stages:

1. On or before the original due date,
2. One day after due date,
3. 30 days after due date,
4. 60 days after due date,
5. 70 days after due date, and
6. Beyond 70 days.

At each of these stages, assign a specific action. For example, you might offer early or even

on-time payment incentives to help customers make the first stage consistently. As you move down through the stages, increase the severity of your actions — from friendly reminders (e-mails, phone calls) to more strongly worded requests for payment. Keep a collection agency on the table but remember that using one will likely cause you to lose the customer.

Also bear in mind that, if you can't collect on a debt, you generally can write off uncollectible outstanding debts as ordinary business expenses. Your deductible amount is limited to the amount of the uncollected, outstanding debt that you've previously included in your gross income.

You'll need documentation of the customer's promises to pay, your collection efforts and why the debt is now worthless. In addition, if you use the cash method of accounting for tax purposes, you can't deduct the debt because, under this method, income isn't reported until payment has been received.

Show empathy, be strong

The difficult economy has put a strain on just about everyone. So it's important to show some empathy to slow-paying customers. Still, even in more robust economies, only the strong survive. Do what's necessary to ensure you get paid. ♦

Using a credit monitoring service

To keep a closer eye on customers and vendors, as well as their own credit, many companies are turning to credit monitoring services. Initially, these firms' bread and butter was helping prevent identity theft by alerting a client of any changes to its credit report.

While this is obviously still a big component of their offerings, such businesses have recently expanded into other areas. For example, some now offer automatic e-mail alerts whenever anyone buys a client's business credit report. You might think of this as "competitive counter-intelligence" — for example, when someone else is checking up on you.

One provider is the credit report people, Equifax Inc. (equifax.com). It sells a product called Business Credit Monitoring™ that alerts clients when a business customer or vendor may be facing financial difficulties. Another option is Intersections Inc. (intersections.com). This firm offers a number of similar corporate identity risk management services, including credit monitoring.

The choice isn't always clear

Trying to determine whether you should buy or lease, well, *anything*, is complicated. There are many tax, financial and practical issues to consider. The decision also depends in part on the type of asset, so let's consider two prime concerns for business owners: office space and equipment.

Surveying your space

For many companies, there comes a time when owners must decide whether to renew a lease, move on to a different one or buy new (or pre-existing) space.

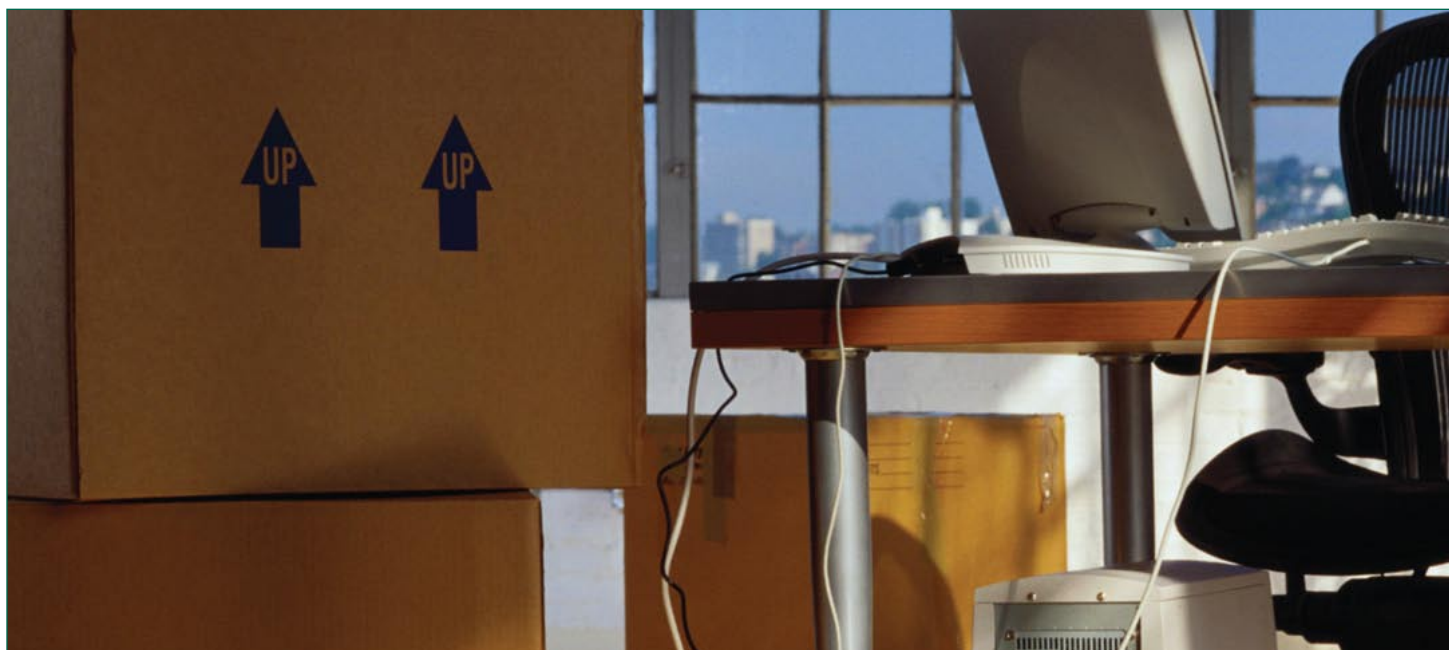
To purchase office space is clearly a big step. But owning your own building can give you flexibility and tax advantages a lease can't offer. For instance, you have more control over how to configure and use the space, you can sublet some if you choose, and you can maintain it as you wish. You'll also benefit from mortgage interest and depreciation deductions at tax time.

Naturally, there are risks to ownership. For one, you won't be able to easily pick up and move on. And if you're structured as a flow-through entity, you'll need to decide how the owners will share the cost of buying and maintaining the building. Keep in mind that the building need not be owned in the same proportion as the business itself.

“Owning your own building can give you flexibility and tax advantages a lease can't offer.”

There are other matters to consider as well. You'll need to delegate responsibility for arranging and overseeing activities such as exterior maintenance, cleaning, and paying taxes and insurance. Plus, if you decide to sublet some of your space, you'll need to wear one more hat — that of a landlord.

Of course, as you may well know from doing it for a number of years, leasing business space has



its downsides, too. Perhaps you've dealt with a particularly unresponsive landlord or property management company. You may also have less freedom to change or rearrange space — not to mention ever-increasing rent and loss of mortgage interest and depreciation tax deductions. If you decide to move, though, it's easier to leave a rented office than to sell one you own.

Ultimately, it's a question of net present values. Will the present value of the capital appreciation you ultimately gain when the property is sold be greater than the current cash flow advantage you'd likely have under a lease?

Considering your equipment

The buy vs. lease question also comes into play with equipment. Depending on the type of work you do, it may not be quite as big of a decision. Yet it's still important.

Leasing equipment does offer some tax advantages. Doing so generally allows you to deduct monthly payments from your taxable income, while you may have to depreciate the cost of equipment you bought (if you don't qualify for the initial write-off under the Section 179 expensing election).

Leasing also may be the better option if you have a lot of technologically advanced equipment that will

probably become obsolete in a few years. Under a lease, you can simply return the equipment when the term is up. If, however, the equipment is likely to still be serviceable for several years after it's paid off, buying may be more cost-effective.

Also think about where you see your company going in the near future. If you're planning to expand, go paperless, merge with another business, or make any changes that will affect the equipment you require, factor those plans into your decision-making process.

“Leasing may be the better option if you have technologically advanced equipment that will probably become obsolete in a few years.”

Weighing the pros and cons

When it comes to the buy vs. lease conundrum, there aren't many clear answers. Ask your CPA for help weighing the pros and cons of any purchase-or-lease decisions you're facing. Details and a keen eye for the future matter greatly in making the right choice. ♦



Intrafamily loans: Know what you're getting into

When money is tight, and particularly when job losses affect an extended family, the prospect of an intrafamily loan often comes up. After all, why go to an impersonal bank when a family member is only a phone call away?

Yet, if not conducted carefully, these arrangements can lead to awkwardness, if not outright conflicts. There may also be tax implications. Here are some things to bear in mind before making an intrafamily loan.

What are we doing?

The first thing to consider when the prospect of a loan comes up is whether you're truly discussing a loan. If, deep down, you know that, should push come to shove, you wouldn't seriously pursue the loved one should he or she fail to pay back the money, you're likely better off gifting the money — or simply refusing. Keep in mind that many family conflicts arise from failure to repay loans, which can lead to awkwardness at best and estrangement at worst.

“Formalize the transaction to clarify the expectations of both parties and help avoid negative tax consequences.”

If you do decide to move forward with an intrafamily loan, formalize the arrangement as much as you can. This should include a signed, written document that spells out the loan's terms and a repayment schedule.

By formalizing the transaction, you'll clarify the expectations of both parties as well as help avoid negative tax consequences. In addition, you'll have the necessary documentation to support a bad-debt deduction in the event the family member defaults.



How can I be sure?

The IRS tends to look for several indicators to verify a loan's authenticity. One is a written agreement and repayment schedule. The IRS also examines whether the borrower executes a promissory note and sticks to the repayment schedule.

Among the most significant factors to the IRS, however, is whether appropriate interest is charged. You should generally calculate interest according to the applicable federal rate (AFR). Any loan in which the borrower is charged less than the AFR at the time the loan is made is considered "below market" and, if challenged, will likely trigger both income and gift tax consequences.

Even if you meet all the general criteria for a loan, the IRS could still recharacterize an otherwise bona fide loan as a taxable gift if it believes the money was lent only for tax-saving purposes.

Who can help?

As you can see, intrafamily loans pose a risk in terms of both family relationships and tax liability. Although your CPA probably can't assist with the former, he or she can help you structure an intrafamily loan that will stand a good chance of avoiding trouble with Uncle Sam. ♦

3 simple steps to better personal credit management

The rough economy and its slow recovery have had marked effects on many people's personal finances. One example: Many Americans are leaning harder on their credit cards. Doing so puts them at greater risk for not only overextending that credit, but also falling victim to fraud as their account numbers go into wider circulation.

And if you happen to be a business owner, the risk is even greater. In composing loan agreements, banks are increasingly looking into a company owner's personal credit history, including personal guarantees.

The good news is that everyone — business owner or otherwise — can create a relatively simple credit management plan. Here are three steps to follow:

1. Know the agencies — and keep in touch. You've probably heard the names before, but they bear repeating: TransUnion (transunion.com), Equifax (equifax.com) and Experian (experian.com). These are the three major agencies from which you can request a credit report.

Under the Fair and Accurate Credit Transactions Act, you may obtain one free copy of your credit report annually from each of these agencies. This is a key first step to managing your credit. To ensure better awareness throughout the year, request a report from one of the agencies once every four months.

This way, you'll be able to track any changes to your credit history.

2. Check your score (and more). Each time you review your credit reports, look at a couple of things. First, check your credit score. If you're at 750 or higher, you're in excellent shape and should continue managing your credit as you've been doing. But if you're drifting into the 500s, you're headed for trouble and need to reassess your credit practices.

Second, look for discrepancies and fraud. To dispute anything, you'll need to provide supporting documentation and a letter of explanation to all three credit agencies. Be sure to challenge any inaccuracies within 60 days.

3. Keep your balances low and your lines open. With your credit history and score, move forward into the spending year armed with some best practices. For starters, to the extent possible, keep your balances low on credit cards. If you run balances that exceed 50% of your credit line on an account, your credit score will likely suffer.

Also, don't make the mistake of closing down credit lines once you've paid them off. Your credit score is partly based on how many lines of credit you can keep open and in good standing. So hide a credit card away if you must, but don't shut it down unless you feel it's simply too great a temptation to spend more than you should. ♦



Not Just Outstanding Service. Proven Effectiveness.

At Mallah Furman, we've always believed that looking back shows us how to move forward. As we look at our accomplishments over the past four decades, we find that our strong focus on client service has played a key role in both our and our clients' success. As a result, timely, responsive, friendly and effective service continues to be our top priority.

Many of our clients have been with us as long as our senior partners. We think that says a lot about how well we get to know our clients, their children and their grandchildren. We treat their families like our own and constantly seek ways to increase their financial success.

When our clients make business decisions, they can count on us as for resourceful advice. We consider our job to be first listening to what clients want to accomplish, then providing the services required to meet their needs as cost-effectively as possible.

More than 45 years of excellence

When we opened our doors in Miami 46 years ago, we had a single-minded professional commitment to advise, counsel and deliver value-added solutions for our clients. We still do. All of our directors and staff are dedicated to exceeding our clients' expectations. And judging by the results our talents and hard work have achieved for our large and growing number of clients, we do.

Consequently, we are now one of the state's most highly respected accounting firms, recognized as an affordable and quality alternative to the large national and international firms.

Not just communication — total understanding

The way we see it, our effectiveness depends on building a strong rapport with clients and keeping the lines of communication open. We want to always be available to discuss your needs, answer your questions and consult with you about ways to reach your goals. To do this, we know we must listen carefully to fully understand your changing needs. We take the time required to become immersed in your business and ask probing questions to develop the insights necessary to help you prosper and grow.

Because each client has unique needs, we don't just apply stock solutions. Instead, we draw on our extensive knowledge of specific industries to provide comprehensive, personalized solutions tailored to your special needs.

Services for all your business and personal needs

Mallah Furman offers a complete array of tax, accounting, financial reporting, valuation, and consulting services to individuals, nonprofits, and businesses in a wide range of industries, including health care, law, and international business. For example, we can assist you with:

- Profitability enhancement
- Strategic and succession planning
- Fraud prevention and detection
- Business valuation services
- Mergers, acquisitions and divestitures
- Estates, trust and valuation
- Litigation support
- Partnership and corporate taxes
- Financial reporting services
- Sarbanes-Oxley (SOX) compliance
- Bookkeeping, forecasting and projection
- Internal controls, policies and procedures

Please call to discuss your needs. We would welcome the opportunity to serve you.

