

VINEYARD
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Cultivating Value...Seedling to Harvest

MANAGEMENT ADVISORY SERVICES

WELCOME!

FINANCIAL DISTRESS AND BANKRUPTCY
Warning Signs for the Small Business

Presenter: Thomas P. Benson, CPA, CFFA

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AGENDA/TOPICS TO BE COVERED

Firm Background

Review of Relevant
Recent History

The Way It Was

The Way It Is

What It Means

Warning Signs

Watch Conditions

Summary

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FRAUD DETERRENCE AND INVESTIGATION

THOMAS P. BENSON, CPA, CFFA



- *Seventeen years of extensive and varied public accounting experience*
 - Twelve as a partner with Buffamante Whipple Buttafaro, P.C.
- *Founded the Vineyard Group, LLC in 2004*
 - After ten years of valuable hands on experience in key operating positions with manufacturing firms.
- *Certified Public Accountant in New York State in 1979*
- *Certified Forensic Financial Analyst in 2005*

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ABOUT US

The Vineyard Group, LLC is a multi-faceted consulting firm that offers specialized services in five major areas including:

- Management Advisory Services
- Litigation Support Services
- Fraud Deterrence and Investigation
- Ownership Transition Services
- Emerging Business Services

OUR SERVICE TEAM



Thomas P. Benson
CPA, CFFA
Managing Director



Norma J. Lombardo
CPA, CVA



Scott D. Reed
CPA, CFDA



Michael D. Staley
CPA, CFE



John F. Whipple, Jr.
CPA, CVA



REVIEW OF RELEVANT RECENT HISTORY



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THE WAY IT WAS

- *Focus Was Local or Regional*
- *Information Flow Was Limited*
- *Customers Were More Insulated – Had Less Choices*
- *Pricing and Quality Less Sensitive*
- *“Hobbyist” Management Style Could be Effective*

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THE WAY IT IS

- *Focus is Global*
 - Markets, customers, suppliers, materials, and labor
- *Information Flow is Unlimited*
 - Customers are now looking to replace you 24/7
 - Competition is looking to replace you 24/7
 - Both have necessary tools
- *Margin for Error is Much More Narrow*
- *Tight, Professional Management Structure and Systems Imperative*
- *Must Focus on Quality, Price and Costs*

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WHAT IT MEANS

- *Businesses are fragile – subject to rapid change from myriad of controllable and uncontrollable sources, therefore they must be flexible and adapt to the changing climate*
- *Every small business should be managed like it is at risk of going out of business at any time. There are no guarantees and the value of past success is minimal.*
- *The assessment of financial risk must be expanded to include conditions that would allow or could lead to the erosion or deterioration of a business's financial condition as well as the direct signs that such an event may already be underway.*

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WARNING SIGNS

S*ituation Warrants Evaluation and Potential
Immediate Action*

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WATCH

C*onditions Exist for Problems to Develop*

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WARNING SIGNS

Weakening Balance Sheet Trends

- *Eroding Equity – Large or recurring losses*
- *Lack of Liquidity*
- *Growing or Excessive Debt*

Marginal or Poor Ratios

- *Current – Total current assets compared to total current liabilities*
- *Quick – Same as current but not counting inventories*
- *Debt to Equity – Total debt compared to total equity*

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WARNING SIGNS

Sales or Revenue Stream Decreasing

- *Loss of Major Customer(s)*
- *Trend in Market Segment*
- *General Decline*

Gross Margins Shrinking Unexpectedly

- *Material, Overhead or Operating Costs Escalating*
- *Efficiencies Declining*
- *Changes Made in Pricing or Discounting*

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WARNING SIGNS

Accounts Receivable Aging Growing Older

- *Large Accounts*
- *General Erosion*

Employee Turnover Increasing

*Accounts Payable Getting Stretched Out Beyond
Vendors' Terms – Payment Promises Are Broken*

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WARNING SIGNS

Vendors Demand COD Terms in Order to Provide Goods

Large Number of New Vendors

- *Willing to Give Fresh Credit*

Line of Credit Borrowings Increasing

- *At or Near Borrowing Availability*

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OWNERSHIP TRANSITION SERVICES

WARNING SIGNS

Key Material Costs are Increasing

Industry of Concentration Suffers Downturn

- *i.e. Automotive*

Cash Flow is a Constant Problem

- *Held Checks and Float Become Part of the Daily Routine*

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WARNING SIGNS

*Missed or Late Debt Payments and/or Bank
Covenant Violations*

Debt Arrangements Expired or Close to Expiration

*Business Outlook and Resources Focused on Short Term
vs. Long Term*

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WARNING SIGNS

Survival Tactics When Warning Signs are Present

- *Adopt a Business as “Not Usual” Attitude*
- *Throw Reliance on Conventional Wisdom Out the Window*
- *Devote the Energy and Resources to Figure Out the Problem, Develop a Plan AND Put it in Place*
- *Have the Fortitude to Make the Tough Decisions*
- *It Will Not Just Get Better Next Month or Next Year – There May Not Be a Next Month or Next Year!*

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WATCH CONDITIONS

Lack of Financial Budgets and Annual Spending Plans

- *It is impossible to effectively manage a business if you do not know where you want to go.*
- *Operational, Financial and Administrative Management Systems are necessary to provide information for analysis of performance.*
- *Management by exception is much more efficient and effective than management by crisis.*
 - Comments like “We have money in the bank so we must be doing OK” or “We are on course to match last year” are dangerous.

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WATCH CONDITIONS

Lack of Capital Investment

- *Fixed assets are not being replaced in a timely fashion*
- *Research and development have been reduced*
- *Sales and marketing expenditures have been reduced*
- *Decreased investment in business assets may be a clear signal of cash flow problems (operating or financing)*
- *This can and often leads to worse problems*
 - Increased maintenance expense
 - Decreased efficiency
 - Inability to keep up with customer demand

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WATCH CONDITIONS

“Unplugged” or Disengaged Financial Function

- *Financial arm must be integral part of management with an ongoing direct link to the sales and manufacturing functions (quoting, margin analysis, pricing, etc.)*
- *Bean counter mentality no longer relevant or useful*
- *Financial statements must be “real time” and reliable*

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WATCH CONDITIONS

Undefined Credit Policies and Procedures

- *Few small businesses have adequate credit policies and procedures. They tend to be sales driven and hope that they can collect the amount that is billed.*
- *Long range strategies are being replaced by short term decisions to improve current financial performance.*
 - Credit terms have been relaxed to increase sales
 - Excessive discounts have been granted to speed the collection of cash

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WATCH CONDITIONS

Lack of Business Development Plans – Sales and Marketing

- *All businesses need a well thought out documented plan. Word of mouth marketing and scatter gun tactics are no longer sufficient.*
- *Lack of a plan with measurable objectives and adequate funding equals a significant business risk and vulnerability. A solid and constant “backlog” is crucial.*
- *It may take months or years to replace lost business, no business can afford to wait until they need it to start this process.*
- *Misguided efforts often result in a shift away from an entity’s core business without proper evaluation or preparation and can negatively impact cost structure and liquidity as well as wasting financial and manpower resources.*

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WATCH CONDITIONS

Focus on Top Line (Sales or Revenue) by Management

- *Defining success as growth in sales or revenue is very dangerous since sales growth could come as a result of deeper discounting or taking on poor quality customers.*
- *An increase in sales volume could lead to personnel increases and other capital absorbing decisions resulting in drains on working capital.*

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WATCH CONDITIONS

Reliance on a Few Large Customers

- *Can lead to a false sense of security*
 - Dependency created often leads to decreases in margin due to loss of bargaining position
 - Vulnerability high if business is lost through customer's failure or customer pulling the business
- *Economic downturns affecting the customer's particular industry could significantly impact your business.*

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WATCH CONDITIONS

Disengaged Top Management

- *If ownership or top management do not have a disciplined, focused approach the result is wasted resources.*
- *Ownership or top management must consistently review financial performance and other relevant information and have regular interaction with employees, customers and suppliers to be able to detect adverse conditions.*

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WATCH CONDITIONS

Thin Management

- *Key personnel have important relationships with key partners -customers, suppliers, financial institutions, etc. that if lost could adversely affect the business*
- *Sales people are often the first to leave a faltering Company*
- *Key management personnel nearing retirement or are having health issues may indicate that additional relationships need to be cultivated*

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WATCH CONDITIONS

No External Involvement

- *Small businesses need external influence to avoid having “blinder syndrome”*
- *Periodic outside financial reporting (review or audit) is important to improve credibility with financial institutions*
- *Board of Advisors with outside participation can be very healthy by providing expanded experience and insight*

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WATCH CONDITIONS SUMMARY

- *Conduct a Detailed Review of Current Conditions*
- *Complete a Risk Assessment – Based Upon Findings*
- *Bring in Outside Party for Objectivity and Thoroughness*
- *Create an Action Plan and Complete It.*
- *Review and Update Periodically – Institutionalize the Process!*

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OVERALL SUMMARY

*“**D**estiny is not a matter of chance,
it is a matter of choice.”*