

TRENDLINES



FEBRUARY/MARCH 2009

YOU DON'T NEED CREDIT IF YOU HAVE THE CASH

The fundamentals of cash flow management

What now?

Assessing your personal finances in good times or bad

Give away your company (to save estate taxes)

MONEYLINES

Practical Perspectives

Soon-to-be retirees still see wisdom in 529 plan

YOU DON'T NEED CREDIT IF YOU HAVE THE CASH

THE FUNDAMENTALS OF CASH FLOW MANAGEMENT

If you're a business owner, you've likely either been directly affected by the credit crunch or at least thought about how it could affect your company. Unfortunately, tight credit has left many businesses scrambling for ways to finance their operations in recent months.

Perhaps the simplest solution to this problem is one that often gets lost in the shuffle: cash. That's right, cash. If your cash flow is strong, your need for financing may be much less — or at least less pressing. Let's review some fundamental ways to keep those dollars flowing.

Look at your budget

It's hard to know how to improve your cash flow unless you can sit down and see precisely where your money is going. That's why the first essential cash flow analysis tool is your annual budget.

Examine it line by line. Although maintaining a detailed budget for all company expenditures can be tedious, it's fundamental to good cash flow management. Your budget can facilitate expense tracking and help guide spending decisions to align with your business goals.

A budget is useful only if you update it regularly to accurately reflect your actual spending.

Items in your budget should tie into and support overall company business goals. If you can't effectively demonstrate how an item enables a particular business goal, you should question its merit. This will help you avoid unnecessary spending and make more funds available for allocation to worthwhile business needs.

Also bear in mind that, for analysis purposes, a budget is useful only if you update it regularly to accurately reflect your actual spending. For instance, you may have



overbudgeted or underbudgeted on some items and, thus, spent more or less than you anticipated.

Create a cash flow statement

With your budget as the foundation, work with your CPA to create a cash flow statement. The purpose of this document is to report your business's net increase or decrease in cash.

The statement factors in the cash inflows and outflows of daily business operations, asset purchases, sale proceeds and financing activities. Because it excludes noncash accounting items, you can use it to pinpoint cash flow problems.

If you want to get the most from your cash flow statement, you're likely best off generating one monthly. But quarterly and annual statements can be useful for identifying cash

flow trends. Accounting software packages can help automate and simplify the process of preparing these and other essential financial reports.

Manage expenses

After securing an overview of your company's cash flow, you can start examining specific areas. One in particular is expenses. Here, too, you should look to your records.

Maintaining accurate expense records gives a more complete view of your financial situation, putting you in a better position to effectively manage your company and ensure ongoing profitability. Accounting software can help you automate the meticulous process of expense account organization and records tracking.

As you review your expense data, seek out ways to reduce your company's day-to-day operating expenses. For example, you may find it more economical to outsource noncore areas of the business such as human resources, payroll and benefits management or information technology support.

Or you might implement just-in-time inventory management, with suppliers maintaining inventory for your business as long as possible, saving you storage and interest costs.



What went wrong? An example

Like credit card debt, cash flow problems can easily sneak up on you. One minute you're in tip-top shape and the next you're desperately looking for answers. What went wrong?

Consider the following fictitious example: Wishful Widgets was offered the opportunity to buy a larger quantity of inventory than usual from a supplier to take advantage of a volume discount. Initially, it sounded like a good idea.

Unfortunately, the inventory turned out to be particularly slow-moving. So Wishful wound up paying more in storage costs, interest expense and possible obsolescence than the discount was actually worth. In addition, it sacrificed the chance to stock more fast-moving goods.

The moral of Wishful's story: Look at all the potential consequences of a financial decision before you leap into it. Otherwise it may adversely affect your cash flow in a way you didn't anticipate.

Review collections and payables

Timing is critical when it comes to both the money coming in *and* going out. Conduct credit and reference checks on new customers to validate their payment histories and minimize the risk of collection problems. Consider requiring customers to provide deposits on product orders or services to be rendered and offering discounts for paying invoices early.

Are mistakes hurting you? Prevent invoicing errors and costly collection delays by maintaining current and accurate customer account data. Promptly send invoices to customers — fax or e-mail delivery could quicken the process. Also, follow up quickly on past-due accounts. Don't wait until accounts are 60 or 90 days late.

On the flipside, take a look at your payables. Generally, you shouldn't pay invoices earlier than required unless you're offered a discount. Use your buying power for large-volume and frequent purchases as leverage to negotiate discounts, free financing or extended payment terms.

Operate within your means

When the economy presents challenges, a business is often best off focusing on its core strengths, cutting expenses and operating within its means. Doing so will help keep cash flow strong and lessen your dependency on outside parties, such as lenders, over which you have no control. □

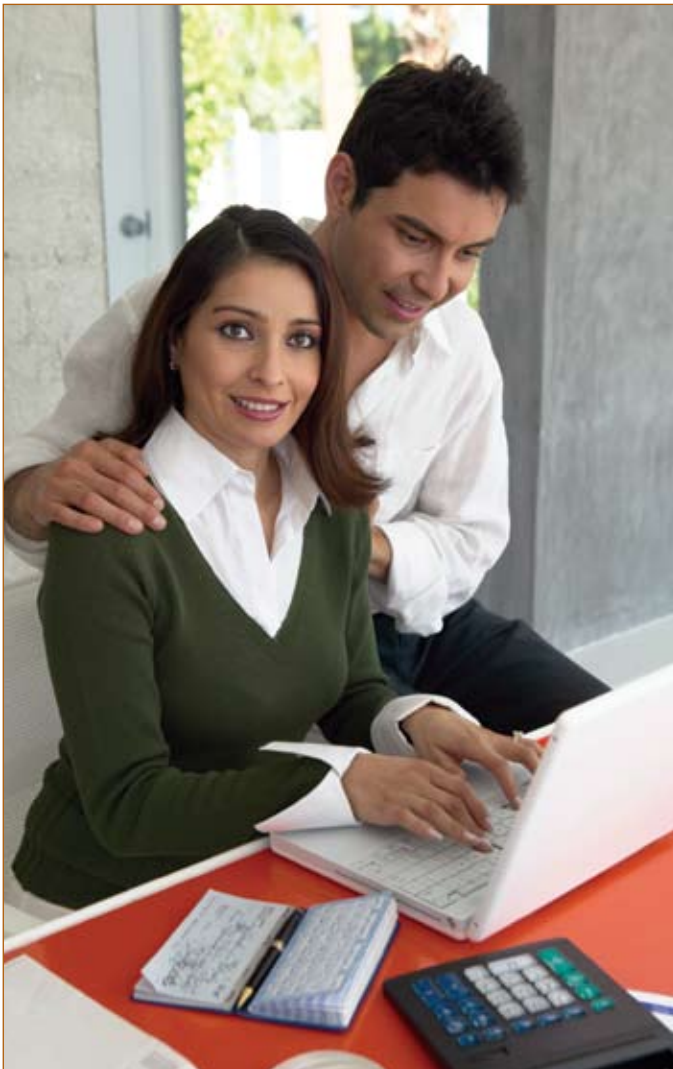
WHAT NOW?

ASSESSING YOUR PERSONAL FINANCES IN GOOD TIMES OR BAD

In economic times like these, you may reach a point where you're so overwhelmed by all the uncertainty surrounding your finances that you ask, "What now?" Well, perhaps the worst thing to do is to start panicking, and the best is to start planning. And even when times are better, reviewing your situation to make the most of any resurgence is a wise move.

Your net worth

Any assessment of your personal finances should begin with your net worth. To calculate this important figure, you need to create a net worth statement. Having information such as this on hand will help you visualize where your finances stand and see whether you're in danger of straying from your financial goals.



What is your net worth? Simply put, it's what you own, minus what you owe. Calculate your net worth by adding all of your assets, including:

- ✓ Cash and cash equivalents,
- ✓ Brokerage account balances,
- ✓ Retirement funds,
- ✓ Real estate and other fixed assets, and
- ✓ Personal property.

Then subtract your liabilities, including mortgages, other loans and lines of credit, credit card balances, and taxes due. What's left is your net worth, and seeing this number on a page (or computer screen) can really put in perspective just how you're spending your money and whether you might be able to do more to grow your savings.

Of particular importance during uncertain times is liquidity. For instance, cash in your checking account is available on demand, while equity in your real estate requires you to sell the property to gain access to its worth. A common rule of thumb is that you should have enough liquidity to cover six months of expenses.

Employer-provided benefits

Once settled into a job, many people lose sight of their employer-provided benefits. Check in on them. Your W-4 withholding status, for example, may need revising if you've gotten married, had a child or incurred some other kind of significant life change. You might also want to change a beneficiary for your employer-sponsored retirement plan, such as a 401(k).

And speaking of your employer-sponsored retirement account, check your deferral amount to ensure you're not putting away too much or too little. Do the same for contributions to your Flexible Spending Account or Health Savings Account (if you have them). Remember that these contributions are pretax, so they don't reduce your take home pay by the full amount of the contribution.

Also keep in mind that 401(k) funds are protected from creditors. On the other hand, you can't access the funds

except in very limited circumstances. But your plan may allow loans in certain situations.

Insurance needs

Another key area to reconsider is your insurance coverage. Many people have seen their home values decrease recently, which may call for a downward adjustment in homeowners coverage.

Life insurance is another critical financial issue to assess. Do you have enough coverage? Too much? Ask your insurance professional to determine the right amount of coverage. If your personal cash flow is particularly slow, you might even consider withdrawing some of the cash flow of your coverage.

Depending on your coverage type and its terms, you may be able to take tax-free loans against the policy's cash value. Typically, current loan payments aren't required;

the principal and all accrued interest are deducted from the death benefit when you die.

Also look into whether you need an umbrella policy. This coverage supplements the liability coverage offered by your homeowners and automobile policies and also covers things they don't, such as medical bills and lost income. Long-term disability insurance also offers key protection in tough times. Ask your employer about whether your benefits package includes it — or could.

A good place to start

Of course, there are other elements to your personal finances, such as your banking arrangements or your IRA or other investments. But your net worth, employer-provided benefits and insurance are a good place to start assessing your financial standing. For additional help, ask your financial advisor. □



MONEYLINES: NEWS BRIEFS FOR BUSINESSES AND INDIVIDUALS

New tax law extends breaks for businesses and individuals. As April 15 gets a little closer, bear in mind the changes that have taken place. The Emergency Economic Stabilization Act of 2008 (EESA), signed into law last fall, extended a variety of tax breaks for businesses and individuals. For businesses, the research and development tax credit, accelerated depreciation for leasehold and restaurant improvements, and a number of energy incentives are still available. Meanwhile, individuals can continue to obtain some relief from the dreaded alternative minimum tax (for 2008 only, though) as well as claim deductions for sales and local sales taxes (if those amounts exceed state and local income taxes) and qualified tuition expenses. Ask your tax advisor for more details.

Social Security Administration (SSA) offers online calculator. Social Security probably won't solely support your retirement, but it may be a nice supplement. Ever wonder how much you'll be getting? Now, whenever the question arises, you can find out by using the SSA's improved online calculator, which uses a database to base benefits estimates on accurate earnings information. To find the calculator, go to the SSA's Web site (ssa.gov) and use the search term "calculator."

Execs expect lengthy siege for easier financing and strategic success. Whether pessimism is a common trait of CFOs is unclear, but few are feeling optimistic about acquiring long-term financing or even accomplishing their strategic initiatives. Or so says the results of a survey released this past fall by CFO Research Services. Of 125 senior financial executives surveyed, 65% are worried about the availability of long-term credit. In addition, 73% reported being anxious about their ability to carry out strategic plans.

Are gas prices affecting your daily commute? If so, you're not alone. Of the 539 full- or part-time workers 18 years old or older surveyed by staffing firm Robert Half International last year, 44% confirmed that gas prices have changed their commutes. That's 10% higher than the results of a comparable survey conducted two years ago. The most common commuting changes reported were increased carpooling or ridesharing (46%), acquiring a more fuel-efficient vehicle (33%) and telecommuting more often (33%).



GIVE AWAY YOUR COMPANY (TO SAVE ESTATE TAXES)

As a business owner, you may count your company among your most valuable assets. From this perspective, it might seem unfathomable to consider giving away your business interests. But, to reduce the estate tax cost at your death and enhance the business succession plan, you may want to do just that.

Giving to get

First, you should know upfront that just because you give away business interests to loved ones doesn't necessarily mean you must cede control of your company. With proper planning, you can save significant taxes *and* retain control.

One key may be divesting while using your annual gift tax exclusions — a strategy that's gotten just a little bit better this year because the annual exclusion amount has gone up from \$12,000 to \$13,000 per beneficiary.

Here's an example: Say that Martin, a widower with five children and nine grandchildren, owns a business worth \$4 million. Using his annual gift tax exclusions, Martin can transfer up to \$182,000 worth of his business annually without incurring any gift tax. That amounts to over 4½% of the business that could be transferred in just one year.

When choosing just how to divest, strongly consider gifting minority, noncontrolling interests in your business. They're generally considered to be worth less than majority, controlling interests and, to reflect this difference,

appraisers typically apply a valuation discount when valuing minority interests. Such discounts allow you to leverage your gifts and transfer more value.

Going back to our example, Martin will be retaining more than 50% of the company, so he's giving away minority interests. Assuming a 30% valuation discount, Martin can increase the underlying value of his gifts to \$260,000 of stock each year but be treated as having made only \$182,000 in annual exclusion gifts. This translates to removing 6½% of the \$4 million value of his company from his taxable estate in one year.

Just because you give away business interests to loved ones doesn't mean you must cede control of your company.

Using your exemption

There's even a way to further boost the size of your gifts. How? Use some or all of your \$1 million lifetime gift tax exemption, assuming you haven't already used it up.

Looking in again on Martin, and factoring in the 30% valuation discount, he can gift nearly \$1.43 million, or an additional 35% of his company shares, to his children and grandchildren gift-tax free with his lifetime exemption. Thus, all told, he can divest himself of 48½% of the company in as little as two days — if he makes annual exclusion gifts on Dec. 31 of one year and Jan. 1 of the next, and also uses all of his lifetime exemption.

Of course, such a plan could backfire if the value of Martin's company decreases. Also, the estate tax exemption available at his death will be reduced by the \$1 million gift tax exemption he used during life. But the benefit of removing future appreciation from his estate makes a current gift more advantageous than a future estate tax exemption.

Finding the proper place

As of this writing, a one-year repeal of the estate tax is scheduled for 2010, so these strategies wouldn't provide a tax benefit for a business owner dying in 2010. But the repeal may be repealed. Consult your financial advisor for the latest information and help with your specific situation. □



SOON-TO-BE RETIREES STILL SEE WISDOM IN 529 PLAN

Frank and Alice are a married couple who are a year or two away from retirement. One of the many goals they'd like to accomplish during their golden years is helping to fund their grandchild's college education.

In the last year or two, they'd read a couple of articles about 529 plans, but they weren't sure whether these arrangements were still worthwhile in light of the uncertain financial markets of recent months. So they visited their financial advisor to discuss the matter.



Their advisor began by explaining that, though it's true that many 529 plans posted losses last year, that doesn't necessarily mean the arrangements have lost their viability. Downturns — even sharp ones — are a risk that every owner of an investment-based fund must anticipate. And these accounts are intended to grow over long periods, not short ones.

The advantages endure

Essentially, 529 plans are investment accounts that may be set up as a prepaid tuition program to secure current tuition rates, a tax-advantaged savings plan to fund college expenses or a combination thereof. Earnings generally grow tax free, and distributions used for qualified education expenses are typically tax free as well.

In addition, most plans allow sizable contributions — between \$200,000 and \$300,000 on behalf of a single beneficiary. And there would be little effect on their grandchild's financial aid. 529 plan assets are generally considered to be the property of the parent or grandparent funding the plan, so the financial aid impact is minimized.

When Frank and Alice mentioned their worries over the recent drastic fluctuations in the stock market, their advisor noted that many 529 plans are now "age-based." That means the account is designed to ride out downturns in the market while their grandchild is young and then automatically shift the investments to more conservative options when she gets closer to enrolling in college.

As account owners, Frank and Alice also would have the power to change beneficiaries, transfer the funds to another 529 plan or even revoke the account (subject to penalties).

A gift tax strategy

Another advantage to a 529 plan that would particularly apply to Frank and Alice is a special gift tax break allowed only for 529 plan contributions. Contributions to a 529 plan are considered taxable gifts to the beneficiary that qualify for the annual gift tax exclusion, which allows a married couple to jointly give up to \$26,000 to each recipient gift-tax free. (Individuals can gift \$13,000 per recipient.)

The special 529 plan break allows Frank and Alice to make five years' worth of annual exclusion gifts at once. That means they could contribute up to \$130,000 free of gift taxes in the first year — and the assets would be removed from their taxable estate. If they died before the five-year period ended, however, a portion of the gift might be included back in their estate.

The choice is theirs

Alice and Frank thanked their advisor that day. He helped them realize that, though 529 plans come with plenty of inherent risks, they remain a standout among several viable options for funding a loved one's college education. □