



## A MANUFACTURING Q&A WITH MIKE SIBLEY

**What are some of the most obvious benefits companies can get from the specialized expertise of a manufacturing-focused CPA?**

Manufacturers have particular inventory, equipment and working capital needs. They have to understand the impact inventory has on their balance sheet and working capital. They have to understand costing methodologies. They've got to connect what's going on in operations with what's going on in finance. A lot of different data points need to be consistent so you can make the right decisions on how to move the business forward. There are also unique tax circumstances for manufacturers.



### **Mike Sibley**

A CPA with nearly 25 years of experience, Mike leads James Moore's Manufacturing Services team and dedicates his work to tax, consulting, and audit services for clients in that industry. He is also the host of Moore on Manufacturing, a monthly video series covering the issues concerning manufacturers today, and serves on the board of the Volusia Manufacturers Association.

If you're using a CPA who doesn't have experience working with a manufacturer, they can miss appropriate ways of properly costing your inventory, understanding working capital needs, understanding ROI equipment needs and future expansion, etc. They won't be as equipped to advise you on how to help your business with manufacturing tax strategies.

## What common tax strategies for manufacturers are frequently overlooked?

The first tax strategy often overlooked is the R&D tax credit. A lot of manufacturers don't understand what the nuances of it are. R&D can be things like process improvement, product improvement and product development... what we call scientific efforts to improve something. That sounds complex, but a lot of times you're just doing it as a natural part of product development/enhancement and process improvement. The wages, materials and supplies involved in R&D can factor into tax benefits.

Additionally, tax reform in recent years has allowed us to take some unique positions with manufacturers that were never allowed before. They can defer income in some cases and take deductions that weren't previously allowed. But you can't look at those in isolation; you've got to look at the impact if you might be selling (or otherwise transitioning) your business. More tax strategies that get overlooked include expanding facilities and taking advantage of depreciation options associated with those expansions and equipment.

Let's not forget state income tax as well. This aspect isn't a tax strategy as much as a compliance issue. If you're delivering in other states, do you have sales



tax issues? Do you have state income tax issues? Not knowing these answers can come back and really harm you down the road, either through compliance enforcement from those states or potentially trying to sell a business and finding out that you have some massive liability out there that was never captured.

Also, when you start talking about things like state income taxes and sales taxes – if you never file, the statute of limitations actually never begins running. So years and years could pass, causing some real significant issues there. If you're operating internationally, the IRS continues to add enforcement of requirements. Noncompliance can result in significant potential penalties.

Every business at some point is looking to transition whether that's a sale to a third party, to employees or to a family member. We want to take a comprehensive look and make sure you don't have these skeletons in your closet. And if you do, we want to work through them. You need to begin that process as soon as you can.

# What are some of the common data challenges that manufacturers face?

Manufacturers often have so much data coming at them from different sources. You've got operational data – scrap, waste, production output, lead times, engineering bill of materials that say what their costs are. Then on the front end of the house you've got the financial side of things – processing invoices, sales, and ultimately financial statements.

These data sets often don't correlate to each other. A company might think it costs them X to produce and they're getting Y for a margin, but the margins and the financial statements don't connect very well. So they're drawing data from different sources. Depending on the source of the data, management might be using outdated information to make decisions.

What often happens is personnel in various departments try to create their own data sets through either some sort of query or reports. And when they draw that information out, they're using Excel and other tools. Well, Excel is prone to errors if somebody keys something incorrectly, has a wrong formula entered or just inserts rows into the sheet. So that data becomes outdated very quickly or it's got errors in it.

What I'm trying to do as a manufacturing CPA is get the right information in front of people to make decisions about operating the business. We utilize our business intelligence team to help connect common data sources to make sure operations personnel are getting good and relevant data. We also create dashboards to help them see their data better and in a more uniform way. This way they can compare their data to their budgets in real time and understand the decisions needed to improve or modify what they're doing.



# In order for a factory to run smoothly, technology (networks, databases, etc.) have to fire on all cylinders. How have James Moore's IT services helped manufacturing clients in this vein?

When people think about IT, they think about the computer systems in their network and the server that runs these programs. And of course, it's really important that servers are backed up so they can continue to process should something go wrong. If anything disrupts operations, that can affect billing customers, paying bills, paying payroll, all of those things.

But what's often forgotten about is the machinery out on the floor. Most of today's machinery connects to the internet, which puts it at risk of being hacked. For the best performance all machinery needs to be operating properly on a network, with proper network settings.

We've had multiple clients who have gotten hit with ransomware. In those situations we were not engaged as their outsourced IT resource, and unfortunately each of them were down for quite some time. They wound up paying the ransom because it wasn't worth trying to recover their files. Why? Their backups were never tested properly, and they didn't work.

We had to rebuild some systems in these cases to make the data sources functional again. If you have the right backup systems and other contingencies in place, with the appropriate network monitoring, you can be back in line in no time compared to what happened to these companies.



# Why is it important for manufacturers to focus on building business value?

Because if you're not thinking about improving, you're falling behind. You've always got to be looking to improve your business through operational efficiencies, product development, looking at your customer base, your credit policies, your administrative processes, how your sales team works, etc. There are so many different aspects.

But most businesses are going to transition out someday. We want to make the business as valuable as possible so you can meet your retirement goals and be able to move away from the business. This means maximizing the value of all you've created. So we focus on the factors that drive value in growth. If you're building that value now, it's going to make you more profitable at the same time.

**So it's important to think about, "Here's where we want to be. Here's where I want to go."**

I've had plenty of manufacturers in the past come to me and say, "Hey, I'm ready to sell my business. I'm not even sure what it's worth. 'Okay, what do you need to retire?' I'm not sure about that either." Many business owners think their business is worth more than it will end up getting. We want to focus on building value to help you better understand it.

# Is a periodic business valuation something that you recommend?

Yes. We always say, "Let's get an understanding of where we are right now." It's not an expensive endeavor to get that understanding, and it's a good benchmark. How often you do this depends on how far away that goal is that we're looking at. It may be annually, or you could look at it every couple of years. But if we're setting a strategy to say, "Hey, we want to grow in value," we need to get a starting point.

Find a professional who really understands your market and what drives it. Of course, there will be a difference between what you might get from a third-party, strategic sale from a private equity versus transitioning it to a family member. But we at least need an independent look at the value from the start.



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While Mike has served organizations representing various industries, his focus lies primarily with manufacturing, construction and other commercial and professional enterprises. As such, he leads the firm's Manufacturing Services Team and provides services requiring complex tax and consulting strategies such as R&D credits, Interest Charge Domestic International Sales Corporation (IC-DISC), inventory costing, developing overhead pools, and retirement planning.

Mike's service to the manufacturing industry goes beyond client work. He serves on the board of the Volusia Manufacturers Association and regularly holds webinars and presentations covering topics relevant to the business of manufacturing.



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