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5 Keys to More Accurate Forecasts

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Forecasting drives supply, production, inventory, and capital expenditure planning as well as financial forecasting. It is often critical to an organization's production or operations department and key to ordering materials, establishing production schedules, meeting hiring demands, training the labor force, and managing logistics. Companies with a strong expertise in forecasting often need to carry less inventory on hand and have a better ability to meet their customers' demand. This leads to improved cash flow, a higher level of customer satisfaction, and in many instances, a higher profit margin than competitors.

However, forecasting can be a time consuming and thankless job. And when done poorly, it is often inaccurate. Here are five steps you can take to improve your forecasting process and deliver more accurate results.

1 Forecast For Customer Demand, Not Sales

Companies need to forecast based on their customers' demands and not their own ability to supply products or services. How much and when a customer needs your goods and services should be the driving factor in creating your company's forecast. This will drive production, raw material needs, inventory levels, and labor requirements. Identify key sources of information and have systems in place to capture it.

2 Identify and Remove Distorted Information

Identify and remove one-time exceptions that can skew forecasts. Distortions can include promotional events, unusual competitor activities, heavily discounted sales to move inventory, and new product entry into a market. It is also important to manage records with a limited history. These should be continually monitored and results updated so the forecast can be adjusted accordingly.

3 Recognize that Communication is Key

As with any process within a company, communication is always a key element of success. Effective forecasts require input from individuals in different functional areas who can contribute relevant information and insights to improve accuracy and the process. Individuals generally need to communicate across functions and this takes cooperation and collaboration.

4 Make Forecasting a Clear Business Step

Forecasting must be a regular process that is performed efficiently and in an effective, productive manner. Performed correctly, it should add significant value to a company's business processes. To be effective, responsibilities must be clearly assigned to individuals within an organization and they must be held accountable. To facilitate the process, make sure users and developers are familiar with the entire process. Organizations that emphasize the importance of forecasting and reward team members often have a higher commitment to the process and see more accurate results.

5 Measure and Publish Performance Results

Develop systems for measuring your performance. Without the ability to effectively measure and track performance, it is difficult to identify issues and inaccuracies and understand what went wrong in order to develop and deliver better forecasts in the upcoming periods. Consider publishing forecast accuracy results to ensure that all team members understand how well the forecast was developed and determine the necessary steps to improve the process.

Good, accurate forecasting takes a lot of time and effort. To be successful, you need to have appropriate systems in place, a well-developed process, and a commitment to providing the necessary resources. Once established, you should see improved customer and employee satisfaction, more efficient and effective inventory and production management, and the ability to better plan and manage the entire operations of your company. **LE**

How Effective Are Your IT Systems?

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In order for companies to ensure they are leveraging the latest IT capabilities to achieve a competitive advantage in the marketplace, management needs to view IT as an investment that is aligned with the company's business objectives. Creating an IT investment roadmap can be a valuable way to assess your current situation and identify future needs.

Here are several ways that properly designed and implemented IT systems can improve your overall organizational effectiveness.

Lower Costs – Properly applied, IT can help organizations achieve more with less, thereby reducing operational costs. By providing workers with information management capabilities to enable them to be more productive, you can reduce the labor cost of production or service delivery.

Improved Process Efficiencies – Many organizations have created procedures to handle specific situational requirements. When viewed individually, these procedures generally do not seem like much. But when you put them all together, you often realize how time consuming and labor intensive they can be. Properly designed IT solutions can overcome organizational boundaries, resulting in more streamlined processes. This in turn allows you to break down artificial functional barriers and increase productivity levels through tightly synchronized operations among your departments.

Increased Quality –Mundane tasks such as manual data entry can result in operator errors, leading to quality problems. IT can help overcome this issue by capturing, manipulating, and presenting information in a more systematic way, which will result in improved quality and decision-making practices.

Better Customer Service – In today's highly competitive economy, customers have numerous choices and the commoditization of many products and services has lowered the switching cost. Customers are increasingly demanding more from their business partners. They want the products or services they need when they need them and they demand pre- and post-sales information on a 24x7 basis. Well-designed IT solutions play a key role in delivering this information, empowering customers to feel more in control of their destiny.

Greater Market Share – When a company runs a lean, efficient operation and delivers world-class quality and customer service, it will automatically attract more customers. In today's era of benchmarks and scorecards available on the Internet, customers are savvier and more educated about their options. It is now nearly impossible to increase market share without making sure the underlying elements of operational excellence are well in place.

Mitigated Risks – With the increased utilization of IT, companies face greater risks of system crashes and security breaches. However, with proper contingency planning, you can create innovative and cost effective disaster recovery and business continuity plans that can be utilized in the event of an unforeseen disaster. Recent developments in cloud-based systems have been a key enabler in this area. IT security, however, continues to be a concern for most businesses. Although there are no 100 percent secure systems, it is imperative to take reasonable precautions such as periodic security reviews to ensure systems are not highly vulnerable to security breaches.

As you continue your journey toward operational effectiveness, consider creating an IT investment roadmap. And, ask yourself a few simple questions:

- Are there areas of your organization that can be improved by IT?
- Do you have instances of more than one individual handling the same information in multiple places or systems?
- Are there capabilities you currently do not have that your customers or suppliers would like to have or will expect in the very near future?
- Are your IT systems highly reliable and secure? **LE**

A Look at the Tangible Property Regulations, aka the 'Repair Regs'

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Historically, the Internal Revenue Service (IRS) and taxpayers have been at odds over whether expenditures on tangible or real property are currently deductible or must be capitalized and recovered through depreciation deductions. After a decade, the IRS has issued final rules on how to treat these expenditures. These rules are called the tangible property regulations, or as they are more commonly known, the "repair regs."

Some of the changes are viewed as a departure from how taxpayers have treated these expenditures on prior tax returns. Taxpayers are now required, or have the opportunity on their 2014 tax returns, to make any necessary corrections by filing accounting method changes or to make various first time elections. Failure to make some of these changes may result in permanently losing the benefit of deducting these expenditures currently and in the future.

Many of the new rules are taxpayer friendly and provide opportunities to deduct expenditures that may have been considered to be capital under the old rules. To quantify these opportunities, taxpayers will need to spend more time reviewing their prior year depreciation schedules and tax accounting policies to determine how these expenditures were treated in the past and their current impact.

Here are some of these potential tax accounting method changes and elections:

- The new rules provide taxpayers another opportunity to review their prior year depreciation schedules and correct improper methods by filing a method change request to ensure depreciation deductions are not lost.
- A very favorable potential method change is the adoption of the routine maintenance safe harbor. Any expenditure that is required to be performed to a building more than once within a 10 year period or more than once within the

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class life for machinery and equipment can now be expensed immediately under this safe harbor. There is no dollar limitation, so this provides an opportunity to potentially expense more than what may have been allowed in the past. By not adopting these changes, these expenditures could be subject to capitalization.

- For buildings, taxpayers now have the opportunity to write off a portion of the old cost from a partial disposition. An example is the replacement of an old roof with a new roof for a building already placed in service. Let's say a taxpayer purchases a building for $1 million and 10 years later replaces the roof. The undepreciated cost of the old roof imbedded in the $1 million original cost can now be written off. This can be applied retroactively, if desired, but there is a limited amount of time to do so.
- The annual election for de minimis safe harbor capitalization policy allows taxpayers to establish a policy to expense up to $5,000 per item per invoice for taxpayers that have an applicable financial statement ("AFS") prepared, which includes audited financial statements. Taxpayers that do not have an AFS (i.e., reviewed and compiled financial statements) are limited to $500. This election may provide opportunities to expense more items in 2014 regardless of the current limitation on Section 179 expense election. Procedures must be in writing and in place at the beginning of the year and the election is made each year by filing an overt statement with the tax return.
- If materials and supplies are currently being capitalized for book purposes, an accounting method change may need to be made to currently expense those items.
- The rules provide for a new definition of a "unit of property," which is the basis for examining whether an expenditure needs to be capitalized. The regulations provide dozens of examples that describe whether an expenditure needs to be capitalized as an adaptation, betterment or restoration, or can be deducted as an expense. This is another example of when a method change may be required.
- In addition to the routine maintenance safe harbor, there is a similar provision for small taxpayers for their buildings. If the amount expended during the year does not exceed the lesser of 2 percent of the unadjusted basis of the building ($1,000,000 or less) or $10,000, then those expenditures may be deducted regardless of whether the expenditure could be considered an improvement.
- A taxpayer can also elect to follow their book accounting method and otherwise not currently deduct repair and maintenance costs if the book policy is to capitalize these costs.

There are numerous potential accounting method changes and elections that could be made with taxpayers' returns for the taxable years beginning on or after January 1, 2014. In many cases, actions not taken during this year may result in unfavorable consequences. We encourage all taxpayers to pay serious attention to these new rules and ensure that they are being addressed. Please contact your Kreischer Miller adviser to discuss these new rules and how they affect your business. **LE**

An Update on the New Revenue Standard

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In May 2014, the Financial Accounting Standards Board (FASB) issued Revenue from Contracts with Customers (Topic 606) under Accounting Standards Update (ASU) 2014-09. Topic 606 was the result of a collaborative effort between the FASB and the International Accounting Standards Board (IASB) to merge, consolidate, and standardize revenue recognition guidance between the FASB and the IASB and across numerous accounting standards and other implementation guidance.

Topic 606 supersedes the current revenue recognition guidance under Topic 605, Revenue Recognition, as well as other industry-specific guidance throughout the Industry Topic of the FASB Codification.

The new standard is effective for public companies for annual periods beginning after December 15, 2016 and interim periods within those annual periods. Early adoption is not permitted for public companies. It is effective for nonpublic companies for annual periods beginning after December 15, 2017 and interim periods within annual periods beginning in the following year. Early adoption is permitted at the public company effective date.

The new guidance will affect entities that enter into contracts with customers to transfer goods or services. The main objective is to standardize the revenue recognition guidance so that economically similar transactions are not recorded differently in financial statements which are in accordance U.S. Generally Accepted Accounting Principles (US GAAP).

The main provisions of the guidance are driven by the core principle to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance outlines the following steps an entity should follow when applying the new revenue recognition guidance under this topic.

Step 1:
Identify the contract(s) with customer.

The new standard defines what constitutes a contract and also addresses how to account for modifications of contracts. Contracts under this guidance meet the following criteria:

- Approval and commitment of the parties
- Identification of the rights of the parties
- Identification of payment terms
- Contract has commercial substance
- It is probable that the entity will collect the consideration which is to be exchanged for goods or services transferred

Step 2:
Identify the performance obligations in the contract.

The standard states that the entity should account for each promised good or service as a performance obligation if it is distinct or a series of distinct goods or services that are substantially the same and have the same pattern of transfer. A good or service is distinct if the customer can benefit from the good or service on its own or with resources that are readily available to the customer and if the promise to transfer the good or service is separately identifiable from other promises in the contract.

Step 3:
Determine the transaction price.

The transaction price is the amount of consideration an entity expects to be entitled to in exchange for promised goods or services. An entity should consider variable

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consideration, estimates of variable consideration, existence of a significant financing component, non cash consideration, or consideration payable to the customer. The guidance provides specific examples and descriptions of types of consideration to be evaluated. The time value of money should be considered when a significant financing component exists.

Step 4:
Allocate the transaction price to the performance obligation of the contract.

Now that a contract, performance obligation, and transaction price have been identified, an entity must allocate the transaction price to each distinct performance obligation of the contract. The guidance provides several options in executing this allocation. The allocation may be further complicated when considering variable consideration, noncash consideration, etc.

Step 5:
Recognize revenue when (or as) the entity satisfies a performance obligation.

As each distinct performance obligation is met, the allocated transaction price should be recognized as revenue. The guidance offers different approaches to recognize revenue if a performance obligation is satisfied over time or at a point in time. For example:

- If the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs,
- Or if the entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced,
- Or if the entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date,

Then revenue may be recognized over time using the percent complete method, milestone method, or another method that represents the progress toward complete satisfaction of that performance obligation.

For obligations that are satisfied at a point in time, an entity should consider when control over the asset is transferred in a contract. Factors include whether:

- The entity has a present right to payment for the asset,
- The customer has legal title to the asset,
- An entity has transferred physical possession of the asset,
- The customer has the significant risks and rewards of ownership of the asset, or
- The customer has accepted the asset.

The statement also provides guidance on additional financial statement disclosures which allow financial statement users to understand the nature, amount, timing, and uncertainty of revenue and cash flows from contracts with customers. Additional qualitative and quantitative disclosures may be required under the new standard.

There are two methods of adopting the provisions of this statement:

- Retrospectively to each prior reporting period, or
- Retrospectively with the cumulative effect of initially applying the standard recognized at the date of initial application.

Under option one, the entity must be able to track, record, and report revenue under the provisions of this statement for up to two years prior to the implementation date. This may require a significant amount of planning and implementation of new processes and controls related to revenue recognition. Under option two, the entity should disclose each financial line item which is affected by the change in the current period and an explanation of reasons for specific changes.

The objective of the new standard is a more unified and consistent method of applying revenue recognition principles to US GAAP financial statements. Overall, ASU 2014-09 Revenue from Contracts with Customers is a substantial standard update which requires a detailed review of its provisions. **LE**

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