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**E-mail and Electronic Media in the Workplace –
Business Owners Beware**

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Technology has forever changed the way people communicate in the modern world. No where is this more evident than in business. Having an e-mail address today is just as essential as having a fax machine was fifteen years ago. Without addressing their social implications, e-mailing and instant messaging (IM) are often used in place of regular mail, phone calls and even face-to-face conversations, in the office as well as in every day life. With this new form of communication now so deeply ingrained in our daily lives, thorny questions often arise such as, “Should one monitor employee e-mail?” “What are the legal implications of such monitoring?” “If one does decide to monitor employee e-mails what should be covered and what should be excluded?”

Federal courts have determined that in monitoring employee e-mails an employer may review all that are stored on company computers. However the interception of an e-mail in transit can be considered a breach of the Wire Tap Act. Yet the reading of a message posted on an electronic bulletin board by someone other than the anticipated reader is not considered a violation of the Wire Tap Act because the message board itself is considered a storage area.

Research has shown that most employees use independent e-mail services, such as Yahoo or G-mail, to send personal e-mails instead of using the service provided by their employers. What many fail to realized is that there is a record of the electronic communication stored on the transmitting computer as well as on the receiving computer. Software exists which makes it possible to trace the originating computer. Under these circumstances courts may next find that privately transmitted e-mail is no more private than e-mail transmitted through the company server.

While the monitoring of stored e-mails may be allowed, one should be mindful of the type of material that is present. Management may not be able to ban certain e-mails that it dislikes, such those relating to union activity, but allow other mundane interactions, such the sale of Girl Scout cookies. Of course there is certain content that can and should be banned

from workplace e-mails. Harassing, vulgar and obscene e-mails are never appropriate as are chain letters, confidential information being sent to those not authorized to receive it, personal commercial solicitations, political promotions, and of course any form of illegal activity. This is by no means an exhaustive list of examples.

Another key issue that can arise anytime one is monitoring another’s behavior is the right to privacy. With proper guidance by one’s lawyer, management may be able to avoid a confrontation on this issue by implementing a policy known to all employees that their internet activity will be monitored while at work or logged on to a company server. Another more direct approach, which should also be first approved by one’s lawyer, is to request the employees’ written consent to internet monitoring. An open policy of regular monitoring of e-mails should help avoid any privacy issues.

While businesses may not be required to store all e-mail, they can be required to produce email records as well as other documents in court and administrative proceedings. A firm has the duty to retain documents that could be considered evidence once it is “reasonable to anticipate a law suit”. The inability to produce the documents can result in adverse rulings by the court or tribunal. Some other examples of situations in which documents should be retained are:

- Upon receipt of a subpoena.
- The occurrence of an incident resulting in injury, death or property damage.
- Threatened litigation (verbal or written).
- When an employee registers a complaint.

Business owners, with the assistance of their lawyer, should devise and implement a record retention policy. In the words of Benjamin Franklin, “An ounce of prevention is worth a pound of cure”.

For more information about your workplace issues and how they may impact your business, please feel free to contact Lynn Lucchese-Soto of our Labor and Employment Law Department.

De-Mystifying Financial Statements

One of the most important topics covered in a company's business plan, whether it is presented to banks or potential investors is an analysis of the firm's financial statements. Financial statements also provide the necessary information to business owners and managers so that they can determine the financial viability of their company compared to industry averages and their competitors. This article will provide an overview of income statements and balance sheets, from which cash flow can be determined.

A firm's cash-flow, also known as its "EBITDA", is the cash generated after having paid all expenses directly related to operations, and therefore the cash available to pay for non-operational expenses such as taxes, and principal and interest payments on debt. **EBITDA** stands for **Earnings**, (the net income or profit after taxes), **Before Interest** (the cost of debt), **Taxes**, (paid to the government based on a company's profit), **Depreciation** (a noncash expenditure for the valuation decline of a tangible asset), and **Amortization** (a noncash expenditure for intangible assets such as patents or goodwill). To determine a company's EBITDA one must utilize the income statement. A sample income statement is provided below.

ABC Corp. Income Statement YE 12/31/07		
Revenues / Sales	700,000	100%
Expenses		
Cost of Goods Sold(COGS)	<u>200,000</u>	28.57%
Gross Profit	500,000	71.42%
Operating Expenses		
Wages	90,000	12.86%
Rent	20,000	2.86%
Selling expense	30,000	4.28%
Depreciation	50,000	7.14%
Amortization	<u>30,000</u>	4.28%
	220,000	31.43%
Operating profit	280,000	40%
Interest Expense	20,000	2.86%
Profit before taxes	260,000	37.4%
Income tax expense	<u>65,000</u>	18.57%
Net income	195,000	27.86%

Based upon the above Income Statement, ABC Corp.'s EBITDA or cash flow is \$360,000. Starting with Net Income, we added back interest and taxes as well as "noncash" item expenses, where no cash is actually disbursed, such as depreciation and amortization. This shows the true cash position of the company.

The income statement is divided into two sec-

tions: "Revenues," a measure of the resources generated from the sales of products or services, and "Expenses," a measure of the costs associated with the selling of these products or services. The accounting equation to remember is :

$$\text{Revenues or Sales} - \text{Expenses} = \text{Net Income}$$

Values used in calculating Financial Ratios are generally derived from the income statement and balance sheet. A sample balance sheet for ABC Corp. is shown below. The balance sheet is a snapshot of the company's assets and liabilities at a given moment of time.

ABC Corp. Balance Sheet YE 12/31/07	
<u>Assets</u>	
Current Assets	
Cash	\$800,000
Accounts receivable	\$100,000
Less: Uncollectibles	(\$20,000)
Inventory	<u>\$500,000</u>
Total current assets	\$1,380,000
Property, plant and equipment	
Property	\$50,000
Buildings	\$350,000
Less: Accumulated Depreciation	(\$100,000)
Total property, plant, and equipment	\$300,000
Other assets	
Patents	\$400,000
Total other assets	\$400,000
Total assets	\$2,080,000
<u>Liabilities and shareholders' equity</u>	
Current liabilities	
Accounts payable	\$50,000
Wages	\$90,000
Short-term debt	<u>\$300,000</u>
Total current liabilities	\$440,000
Long term liabilities	
Bank loans	\$450,000
Mortgages	<u>\$600,000</u>
Total long term liabilities	\$1,050,000
Shareholders' equity	
Contributed capital	\$300,000
Retained earnings	<u>\$290,000</u>
Total shareholders' equity	\$590,000
Total liabilities and shareholders' equity	\$2,080,000

Ratios are expressed as a decimal value, such as 0.10, or the equivalent percent value, such as 10%. Financial ratios are a critical part of financial statement analysis. The ratios of firms in different industries, which face different risks, capital requirements, and competition are not generally comparable. The following are some selected financial ratios.

I. Profitability ratios measure the firm's use of its assets and control of its expenses to generate an acceptable rate of return.

1. **Gross margin** = (Revenue – COGS) / Revenue
Measures gross profit margin the company is achieving on revenues.
2. **Net Operating Income** =
Sales – Expenses (excluding interest and tax) / Sales
Measures income generated from operations .
3. **Net profit margin** = Net profit / Sales
Measures net profit margin achieved on sales.
4. **Return on equity** = Net income/shareholders' equity [Indicates the return on invested capital.]

II. Operating ratios measure how quickly a firm converts non-cash assets to cash assets.

1. **Days Payable** = Accounts Payable / (COGS/365)
How fast the firm pays its bills. It is better to take longer so long as it does not adversely affect business relationships with providers.
2. **Collection ratio (days receivable)** = Accounts Receivable / (revenues/365)
How quickly the company's bills are paid.
The quicker the better.
3. **Days inventory carried** = Inventory / (COGS/365)
Average daily inventory carried.

III. Liquidity ratios measure the availability of cash to pay short term debt.

1. **Current ratio** = current assets / current liabilities
Indicates whether current bills can be paid.
Generally, this ratio should be a minimum of 2 to 1.
2. **Quick ratio** = Current assets – inventory and other non-liquid current assets / current liabilities

Measures liquidity by indicating whether current bills can be paid without selling inventory or non-liquid assets. This ratio should generally be a minimum of 1 to 1.

Application of Select Financial Ratios to ABC Corp.

<u>Ratio</u>	<u>Amount</u>	<u>Explanation</u>
Gross Margin	71.4%	71% (of every dollar) goes to gross profit.
Net Operating Income	40%	40% goes to op. exp. & COGS
Net Profit Margin	27.85%	27.85% goes to the bottom line
Return on Equity	33%	33% return on capital invested
Days Payable	91 days	91 days to pay bills
Collection ratio	52 days	52 days to collect receivables
Days carried in-ventory	912 days	nearly 3 years inventory
Current ratio	3.1	ABC can meet its short term financing.
Quick ratio	2.00	ABC can pay its debt.

As discussed above, this is a broad overview of the tools businesses have to help understand their financial health. However, it is not enough to look at only one year of data. It is important to perform annual or semi-annual comparisons to determine trends. For instance, it is a sign of trouble for revenues to increase while gross margins decrease over the same time period. Also, if net income declines from 25% to 24% and then 19%, the trend is negative even though the individual percentages by themselves may look good. And consider, a goal might be to legitimately minimize Net Operating Income in order to minimize taxes. Thus it does not carry the same weight as the company's cash flow (EBITDA). Future projections of three to five years of the ratios are also important to develop a plan of where the company is potentially headed and to highlight areas to work on.

Beyond this, one must also examine many other factors to determine how well the company might perform over time. For example: What are the opportunities for the company's products or services? What effect does the general economy have? Is there a compelling business plan? What are the strengths and experience of the management team members? Are their skill sets complimentary? How committed is the team to the company's success? Armed with answers to these and other questions, one can better chart a course for growth, which is the entrepreneur's goal.

For more information regarding business and finance issues for entrepreneurs, please feel free to contact Steven C. Weiss of our firm.

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