UHY LLP
Certified Public Accountants

MANUFACTURING INSIDER

VOLUME 12 :: ISSUE 2

In This Issue:

Is Your Company Prepared for the United States-Mexico-Canada Trade Agreement?

Five Tactics for Manufacturers in Recovery

Current State of the Manufacturing Industry

IS YOUR COMPANY PREPARED FOR THE UNITED STATES-MEXICO-CANADA TRADE AGREEMENT?

The United States-Mexico-Canada Agreement (USMCA) is the most sweeping and high-standard trade agreement ever negotiated. The agreement completely modernizes and brings NAFTA up to speed to meet the challenges of a 21st century economy. USMCA seeks to ensure that American workers, farmers, ranchers and businesses including small and medium size enterprises all benefit from the agreement. The goal of the revamped deal is to drive economic prosperity, promote fairer and more balanced trade and allow North America to remain the world's most competitive economic region. With the new agreement comes new requirements for manufacturers and other industries.

By all accounts the belief is the USMCA is a win for all three economies involved, but it will require additional research for companies in regards to certification, labor requirements, and content requirements to ensure that they are compliant under the new agreement.

Increased Regional Value Content requirements for vehicles

The USMCA establishes a Regional Value Content (RVC) requirement of 75 percent as opposed to the 62.5 percent requirement included in NAFTA. At least 75 percent of a vehicle's components must be made in Canada, the United States or Mexico. The 75 percent requirement must be achieved after three years (66% in 2020, 69% in 2021, 72% in 2022 and 75% in 2023), giving companies time to phase in the new standards. It is important that you consider your supply chains to become familiar with new designations such as Core, Super Core, Principal and Complementary Parts.

It is also critical to know where the aluminum and steel used by suppliers and suppliers of suppliers comes from as there is a requirement for 70 percent of those raw materials to come from local sources.

Labor Value Content Rule for vehicles

Another new requirement that comes with the USMCA is that a certain percentage of qualifying vehicles (40 percent of cars, and 45 percent of trucks) must be produced by employees making an average of $16 per hour. Many feel the hourly requirement will level the playing field for the workers fueling one of the world's most important industries. The USMCA has also eliminated loopholes that allowed manufacturers to sidestep the less stringent Regional Value Content requirements set by NAFTA and help ensure that key parts are made within the region.

Continued on Page 2...

Continued from Page 2...

Certification

This aspect of the USMCA could be looked at as a positive or an area of uncertainty as there is no set format for origin certifications. Origin certifications could be included on an invoice or a separate document altogether. An importer may submit an importer, exporter, or producer certification, and the importer is responsible for exercising reasonable care concerning the accuracy of all documentation to US Customs and Border Protection. Certification is not required for non-commercial shipments under $2,500. You can begin to implement these terms into new and existing agreements to become familiar with the new processes under the USMCA.

Reducing the administrative burden on vehicle and parts producers

The new, less-complicated origin procedures contained within the USMCA are designed to alleviate some of the administrative responsibilities for automotive producers and help to maintain tighter enforcement of the agreement's automotive rules. The new origin rules should allow originating status requirements to be more easily met.

Implementation date

Initially set to be implemented earlier this year, the Coronavirus has generated outcry from different parties for postponement until January 2021, but recently it was announced that the agreement will officially go into effect July 1, 2020. However, the Customs and Border Protection (CBP) understands that companies will need time to adjust business processes to achieve full compliance. During the first six months, the CBP will focus on supporting the trade's efforts to comply with the requirements including webinars and other outreach efforts. Therefore, the CBP may in appropriate cases show restraint in enforcement during the six-month period after the USMCA went into force on July 1, 2020.

How can your company prepare for the USMCA?

We have been advising our clients to prepare for implementation as soon as possible in order to experience minimal disruption to your business and to be in the best position for the future.

- Attend webinars by the CBP that will help your company meet the requirements for your sector.
- Don't assume your products are exempt just because they were under NAFTA. Please check the USMCA documentation carefully and review the FAQs. https://www.cbp.gov/trade/priority-issues/trade-agreements/free-trade-agreements/USMCA/FAQs
- Consider changes to your internal procedures to maintain supply chain compliance under the USMCA. This could include evaluating the differences between NAFTA and USMCA, knowing that qualifications under NAFTA and USMCA could be different and additional strategies will have to be implemented to adhere to origin rules.
- Perform an analysis on your bill of materials to ensure your materials and purchased components meet the origin requirements. Also, reach out to your downward stream suppliers to understand if they are prepared to meet the requirements with USMCA.
- Create a process to provide certificate of origin. See Annex 5-A of USMCA for items that must be included.
- Visit CBP for complete details on USMCA implementation instructions: https://www.cbp.gov/sites/default/files/assets/documents/2020-Jun/USMCA%20Implementing%20Instructions%20-%202020%20Jun%2030%20%28Finalv1%29.pdf

By Tom Alongi, National Manufacturing Practice Leader
(Sterling Heights, MI)

"We have been advising our clients to prepare for implementation as soon as possible in order to experience minimal disruption."

FIVE TACTICS FOR MANUFACTURERS IN RECOVERY

What is the "new normal" going to look like for the American manufacturing industry? This question has been on everybody's mind in recent weeks and will be contemplated, and perhaps remain unanswered, for many months to come. In the meantime, as our country begins to reopen and starts down the road to recovery, manufacturers will need to make critical decisions that will determine how they emerge from the COVID-19 crisis. Executives are facing difficult decisions around cash management, workforce, capital allocation, and investment in innovation. Which businesses, product lines or service offerings warrant continued investments and which ones do not?

In a period of crisis with such uncertainty, decision-making has never been more challenging. However, these challenges can be overcome. We are seeing many organizations not only survive, but thrive, during the crisis by "manufacturing" opportunities. In many cases, these items have been on board agendas for some time, but immediate action was made essential for survival by the current environment (for example, diversifying distribution, enhancing digital marketing platforms, and outsourcing or automating certain repetitive processes). Whereas, many new opportunities have been created through collaborative decision-making as companies have sought to "pivot" their businesses in order to meet the high demands of the crisis (for example, manufacturing and distributing ventilators, hand sanitizer, PPE and field hospital rooms). We have also seen companies innovate by building relationships with non-traditional business partners and industries. For example, there has been a "blurring" of the lines between the healthcare, technology, and manufacturing sectors.

To succeed through the pandemic, American manufacturers will require collaboration, structure and innovative decision-making within their organizations. It all starts with asking the right questions. Instead of "what is the new normal" going to look like, should businesses be asking "how should my new normal look in order for my business to thrive during the crisis and beyond"?

Remember before the COVID-19 pandemic (just a few months ago), many businesses were already asking these types of questions; to name a few, they were asking about digital transformation, the customer experience, robotic process automation, data and predictive analytics, and corporate responsibility and sustainability. Manufacturers who were not asking these questions before should be asking them now.

The Business Roundtable (BRT), an association of close to 200 CEOs of major US corporations, acknowledged the importance of aligning the primary objective of a firm with the long-term value drivers relevant to **all** stakeholders. On Aug. 19, 2019, the BRT formally adopted a new 'Statement of Purpose of the Corporation (SPC).' In its proclamation, the BRT committed corporate America to creating value for all stakeholders by adopting a five-fold mission: to deliver value to customers, to invest in employees, to deal fairly and ethically with suppliers, to support the communities in which we work, and to generate long-term value for shareholders[1]. Even during challenging times, American manufacturers should not lose sight of the BRT's SPC. Although urgency and decisiveness are needed, organizations cannot lose track of the long-term implications that each decision will have on their business, culture, mission, and society. This article presents 5 tactics to help American manufacturers better position themselves to ask the right questions,

Continued on Page 4...

1 Has corporate America renounced shareholder wealth maximization? (2019, September 23). Philippines Daily Inquirer [Makati City, Philippines]

Continued from Page 3...

make timely, well-informed decisions, and ultimately to position themselves stronger during and after the crisis. These tactics are based on our observations from businesses that have been successful before and through the crisis.

1. Establish a governance structure, which includes a Special Purpose Project Management Officer (PMO). To make quick, thoughtful decisions that are in the best interests of the company, organizations should establish a "crisis management committee" comprised of leaders across the organization. A cross-functional team will facilitate information gathering, knowledge sharing and "horizontal" decision-making. A horizontal approach positions organizations to make decisions across multiple dimensions (distribution channels, geographies, product lines, and customers) and identify those dimensions that are generating cash and profit, and those that are not (also see tactic 2). In a period of supply chain disruptions and demand shocks the industry has never seen before, where timely decisions are needed around resource allocation and prioritization, manufacturers will need to assemble a team of leaders with insights across the organization that are empowered to act. This may represent a shift in thinking for many manufacturers that are used to making decisions "vertically".

The crisis management committee will differ depending on the size of the organization. For smaller manufacturers, the current executive team may be able to serve this role. Meanwhile, larger manufacturers may need to establish a Special Purpose PMO that works closely with the executive team. The committee should be representative of the entire organization and include executives from sales, supply chain, product management, finance and information technology.

The effectiveness of the crisis management committee will be driven by its mandate and communication protocols. The committee's mandate, with the oversight of the board (and executive leadership team, if separate from the committee), is to reassess the company's vision, mission and values and to establish the company's strategic plan through the pandemic; with a long-term perspective on recovery and corporate sustainability. The execution involves establishing and monitoring key performance indicators, prioritizing projects and tracking their progress, and allocating (capital, financial and human) resources. The crisis management committee should meet frequently and have regular interactions with the board. Similarly, Boards may need to adjust their quarterly meeting schedules to a more frequent cadence (monthly meetings).

2. Identify profit drivers to maximize recovery. In these unprecedented times, it will be important that management's decision-making process is based on objective, detailed data. In the current environment, an aggregate view of gross-margin by product, geography, or some other dimension, with the objective of growing the top-line across all customers may no longer be the right approach, especially for manufacturers with multiple segments. Markets are fragmented, and costs and profits can vary significantly by customer or product depending on customer relationships and supply chain integration. In this market, manufacturers should consider tracking data at a granular (invoice) level to arrive at a true profit that can be analyzed across multiple dimensions; in other words, mapping profits to specific customer segments, products and distribution channels, and reporting across these variables. The ability to identify and evaluate the company's profit drivers will enable the crisis management committee (see first tactic) to set prioritization and resource allocation strategies around the manufacturer's segments, products and channels, and perhaps even decide whether the company must restructure in order to be successful in the long-term.

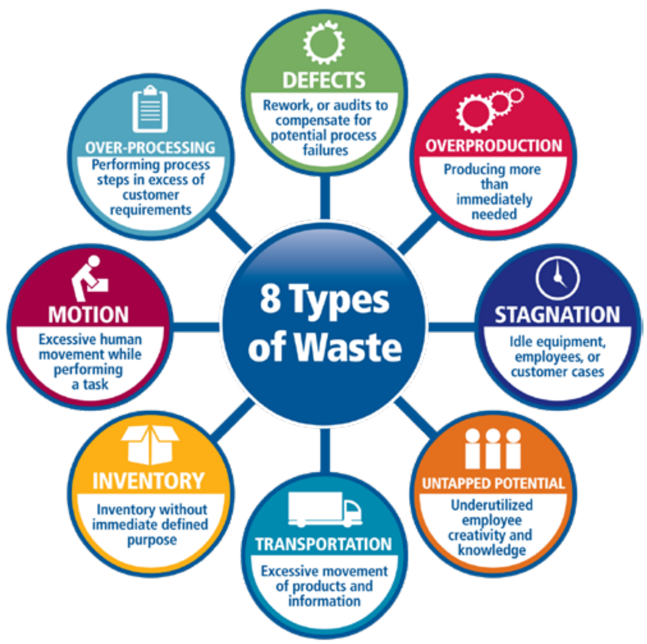
These are some of the questions that management should be asking themselves:

- Do we have data at a level of detail to effectively evaluate what combination of customers, products and services will be the most profitable going forward?
- Have we been measuring and managing profit at a level that allows us to make the best decisions possible for the organization (both in the short-term in response to the crisis and in the long-term in anticipation of recovery)?
- What customers are the most profitable? Which customer relationships should we prioritize?
- Which product offerings are most profitable? Where are my greatest risks associated with supply chain disruptions? What third-party suppliers and vendors should we prioritize?
- What are the impacts of taxes and tariffs on my operations?
- Should we close facilities or relocate operations?

Prior to the COVID-19 Pandemic, studies have shown that up to 30%[2] of a company's products or customers may be unprofitable. A quick identification of less profitable business will allow a company to take short term steps to reduce losses and negative cash flow from these identified operations.

3. Identify sources of waste for business process optimization.

Manufacturers should quickly identify and immediately address sources of waste. The "Waste Wheel" is a tool that can be used by the crisis management committee or executive team to execute the company's strategy.



- Inventory – is there expiring inventory that can be sold at a reduced price or donated?
- Stagnation – is there idle equipment or employees that can be redeployed?
- Over-processing – have "on-the-fly" process changes added unnecessary steps that can be eliminated?
- Overproduction – is the right mix of products or services still being delivered?
- Defects – has a reduction in operations increased process failures that require better documented standardized procedures and cross training?
- Motion – has social distancing or working remotely caused excessive employee movements that require better physical and/or electronic workspaces?
- Transportation – has working remotely added excessive movements of information (emails) that require better collaboration tools?
- Untapped potential – are employees and their collective problem-solving skills being utilized?

In recent years, many manufacturers began to re-evaluate their manual and repetitive processes to identify opportunities for performance improvement and cost savings through the use of automation, artificial intelligence, shared services, and outsourcing. In the last few months, this has become a necessity for many organizations. Manufacturers that have yet to optimize their business processes, should consider this a priority.

4. Establish an agile scenario planning and forecasting process. During this uncertain period where forecasts beyond 13 weeks are nearly impossible to predict, scenario planning can be a key risk management tool for the crisis management committee and executive team. Rather than spend time estimating EBITDA, cash flows or other key measures over a longer time horizon when forecasts are at best an "educated guess", manufacturers should focus their efforts on developing reasonable scenarios for

Continued on Page 6...

2 https://www.profitisle.com/

Continued from Page 5...

their businesses. For example, consider three scenarios based on the anticipated length of the pandemic[3]: 9-months, 1-year, or 18-months? Given these base scenarios and other outside factors, an organization can then devise additional scenarios based on how the economic recovery may look: v-shaped, u-shaped, or w-shaped. Management then develops business strategies under each of these scenarios, so that it is prepared to execute once the higher likelihood of a particular scenario occurring becomes apparent. The crisis management committee (or similar) should establish parameters that indicate which scenario(s) becomes more likely to occur over time. The crisis management committee continually monitors these parameters and adjusts its action plans accordingly. Scenario analysis is a tool that mitigates forecast model risk in a period of unpredictability and volatility. A longer-term scenario planning process complemented by shorter-term (13-week) cash flow forecasting and modeling could be a powerful combination for manufacturers in this environment.

5. Develop a resource recovery and workforce development plan. Employee safety should come first as organizations develop and implement their resource recovery plans. As manufacturers begin to reopen and employees return to offices and facilities, the management team's communication approach will determine the level of employee morale and engagement. It will be critical for management to deliver a transparent, genuine message around the company's recovery plan. Management should also give their teams a mechanism to provide feedback. Each individual has their own emotions about the pandemic, so understanding how they feel about returning to work in the new environment is an important step to maintaining trust with the staff, making sure they feel safe, and ensuring that they can be productive. Management should develop written safety and health protocols, communicate these to all employees, and provide each employee with an opportunity to provide confidential feedback given their personal situation.

Establishing a "development culture" is another key element to a successful resource recovery and workforce development plan. These are some of the questions that management should be asking:

- In a remote work environment, what strategies, protocols and technology platforms should our teams employ to remain connected, to support appropriate oversight of junior staff, and to provide an effective on-the-job training environment?
- With an increased reliance on technology to operate, will our less technically skilled employees require training to stay relevant?
- Should we modify our training programs to reach remote employees?

During these difficult times, employee and community engagement are essential. Bringing an organization's staff together to make a difference in the communities they serve can be a wonderful boost to team morale and employee engagement. This may require some creative thinking with social distancing protocols, but community-impact events are happening, teams are having fun, and businesses are making a significant difference at a time when it is needed most.

As manufacturers look towards recovery, they should not lose sight of two of the goals established by the BRT: to invest in employees and to support the communities in which we work. Businesses with this mind-set will be more successful over the long-term.

Michael Poveda, Partner
(Albany, NY)

> "During these difficult times, employee and community engagement are essential."

3 These scenarios are used for illustrative purposes only. Each company should employ a thorough analysis to determine appropriate scenarios based on their specific facts and circumstances.

CURRENT STATE OF THE MANUFACTURING INDUSTRY

According to a new Standard & Poor's report, there are two key indicators that will tell you what kind of shape the manufacturing industry is in. The first is the Institute for Supply Management's Purchasing Manager's Index and the second is the Federal Reserve's Capacity Utilization Index for motor vehicles and parts. A reading above 50 percent for the ISM index indicates that manufacturing is expanding in the US, and below 50 means that it is contracting. History shows that each time since 1983 that the index fell below 43 percent "speculative grade" automotive companies began to panic. Similarly any time the Fed's utilization rate dropped below 72 percent during that period, it caused stress to automotive companies. Let's take a look back at the trend over the past year:

RECENT TREND

AS OF **APR '20**

ISM Purchasing Manager's Index: 41.5%

Fed Capacity Utilization Rate: 61.1%

AS OF **DEC '19**

ISM Purchasing Manager's Index: 47.2%

Fed Capacity Utilization Rate: 75.2%

AS OF **NOV '19**

ISM Purchasing Manager's Index: 48.1%

Fed Capacity Utilization Rate: 75.7%

AS OF **AUG '19**

ISM Purchasing Manager's Index: 49.1%

Fed Capacity Utilization Rate: 75.7%

MANUFACTURING INDUSTRY INSIGHT

UHY LLP recognizes that manufacturing companies require their auditors, tax specialists and business advisors to add value to financial reporting activities. That is why we combine the strength of business and financial expertise with a hands-on, "shop floor" approach to solving complex business decisions in these key segments:

- Aerospace & Defense
- Distribution
- Automotive Suppliers
- Industrial Manufacturing
- Consumer Products

Our professionals are leaders in the industry and take the steps necessary to ensure our client's future success by identifying and addressing new trends, accounting requirements and regulations.

OUR LOCATIONS

CA Irvine 949 623 8803
CT Farmington 860 676 9020
FL Miami 305 438 7993
GA Atlanta 678 602 4470
MD Columbia 410 423 4800
MI Ann Arbor 734 213 1040
MI Detroit 313 964 1040
MI Farmington Hills 248 355 1040
MI Port Huron 810 984 3829
MI Sterling Heights 586 254 1040
MO Kansas City 816 741 7882
MO St. Louis 314 615 1200
NY Albany 518 449 3171
NY Catskill 518 943 4502
NY Hudson 518 828 1565
NY Kingston 845 331 5030
NY Long Island 631 712 6860
NY New York 212 381 4800
NY Saratoga Springs 518 583 1234
NY Rye Brook 914 697 4966
TX Houston 713 325 7870