State of Accounting:
POINTS OF VIEW FROM THE MANAGING PARTNERS' DESKS

AS THE FINANCIAL LANDSCAPE CONTINUES TO SHIFT AND ADAPT TO THE WORLD'S "GOINGS ON," it's always good to get advice and perspectives from those in the know. With this in mind, the Los Angeles Business Journal has turned to the managing partners of some of the leading accounting firms in the region to get their assessments regarding the current state of business accounting, economic variables, and the various trends that they have been observing, and in some cases, driving.

Each of these fiscal thought leaders has offered their unique perspectives with columns that generously share their insights and points of view. Thanks to these financial stewards of Los Angeles and the unique outlooks they have provided – offering a glimpse into the state of business accounting in 2017 – from the perspectives of those delivering financial advice and leadership to the businesses of our region today.

STATE OF ACCOUNTING

T-Minus Five Months Until ASC 606: Are You Ready for Launch?

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PUBLIC companies have less than five months to get up to speed with a new way of reporting revenue.

On Jan. 1, ASC Topic 606, Revenue from Contracts with Customers, takes effect for publicly traded organizations, and all other companies must follow suit in 2019.

Issued by the U.S. Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) in May 2014, the standard aims to create a more comprehensive picture of revenue recognition—comparable across industries and across countries.

The key principle of the standard is that a vendor should recognize revenue to show the transfer of promised goods or services to customers in an amount that reflects consideration to which the vendor expects to be entitled in exchange for those goods or services. The timing and pattern of revenue recognition will likely change for many entities regardless of industry. In some areas, the changes will be significant and will require careful planning.

The standard will require organizations to determine revenue recognition based on five steps:

1. Identify the contract with the customer. A contract creates enforceable rights and obligations between a vendor and its customer.

2. Identify separate performance obligations. A performance obligation is a promise by a vendor to transfer goods or services to a customer. Each one is a distinct good or service from which the customer can benefit on its own.

3. Determine the transaction price.

4. Allocate the transaction price to separate performance obligations.

5. Recognize revenue as or when performance obligations are fulfilled. A vendor must assess when it fulfills each performance obligation and recognize revenue accordingly. This is based on the point at which the customer obtains control of the good or service.

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Outside of these five steps, the standard also includes a new disclosure objective, as well as enhanced disclosure requirements for recognizing revenue. So, while the timing and pattern of revenue recognition might not always change, new or modified internal processes might still be needed to comply with the broadened disclosure rules.

The bolstered disclosure requirements aim to remedy a long-time FASB and IASB complaint: previous disclosure requirements were inadequate and often provided insufficient information for users of financial statements to understand revenue sources. This has resulted in erred key judgments made based on that inaccurate information.

The Securities and Exchange Commission (SEC) is also expecting companies to provide SAB 74 disclosures in their annual and quarterly reports before adopting ASC 606. The SAB 74 aims to inform stakeholders of the impact the adoption of the new revenue recognition standard could have on organizations' financial statements. The SEC recommends that companies unsure of the impact make a statement to that effect.

According to the ***2017 BDO RiskFactor Report*** series, which examines the risk factor sections in the latest 10-K filings of the largest 100 publicly traded U.S. companies by industry:

- 11 percent of **life sciences** companies cited revenue recognition as a risk to business (to be published in September).
- 7 percent of **real estate investment trusts (REITs)** mentioned revenue recognition as a concern.
- 12 percent of **retail** companies noted revenue recognition as a worry for business.

The new standard will require companies to critically review and inventory all stated and implied contractual rights, and carefully apply professional judgment. Subtle changes in contractual provisions or business practices could result in very different accounting outcomes. But with enough focused effort, consultation and coordination, having a clear, well-documented path towards ASC 606 adoption at the beginning of 2018 is achievable.

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As Year-End Planning Approaches, Hedge Your Bets with Tax Reform

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ALL eyes are on Congress this fall as legislators tackle the tax reform issue. A joint statement released July 27 from leaders in the House, Senate and National Economic Council stresses that Republican leadership hopes to see tax reform passed by mid-November.

Tax changes proposed by the Trump administration include corporate and individual tax rate cuts, and lower tax costs for repatriated earnings. Corporate tax rates would drop from 35 percent to 15 percent. Individual tax brackets would be consolidated into three brackets, 10, 25 and 35 percent. Standard deductions would be increased for individuals and all itemized deductions would be eliminated with the exception of the deductions for charitable contributions and home mortgage interests. The net investment income tax (NIIT) and the alternative minimum tax (AMT) would both be repealed.

If they come to pass, the tax cuts would significantly affect planning for transactions and financial instruments. Whether those cuts pass before the end of 2017, however, may be a stretch.

THE ROADBLOCKS TO TAX REFORM

It is likely that the budget reconciliation process will be used to pass tax reform. Budget reconciliations allow for a simple majority vote, but the measures passed must be deficit neutral after 10 years.

In the spring, President Trump's Treasury Secretary Steven Mnunchin said the tax reform plan would "pay for itself" through economic growth. However, the Tax Policy Center estimates that even with possible tax increases, the revenue loss from President Trump's Tax Plan could be $3.5 trillion over the first decade and $5.7 trillion 20 years out.

Savings from the repeal and replacement to the Affordable Care Act were going to help offset the deficits caused by the tax cuts, but when the so-called "skinny repeal" of the ACA failed to pass in July, the future of health care reform looks much less certain. Paying for the tax cuts could therefore be a significant issue that Congress will have to work through.

Other legislative priorities may also bump back the tax reform timeline. Congress is gearing up for discussions over whether to raise the debt ceiling. Some members of the House and the Senate have said they will not pass a debt ceiling increase without spending cuts and budget reforms, which would likely draw out the debt ceiling vote and in turn likely delay tax legislation.

TAX REFORM'S EFFECT ON THE MARKET

The stock market has already priced itself as if tax reform will happen. July was a strong month for both the Dow and the S&P 500, with the latter experiencing 29 record closes this year. Publicly traded corporations may be trading in the expectation that a reduction in corporate tax rates is coming and that they may be able to repatriate foreign earnings at a lower tax cost.

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Because the markets are preparing for tax reform, there may be a slight downturn if changes are not passed in 2017. You may want to evaluate your financial investments and select a hedging strategy to help mitigate the effects of losses in the fourth quarter.

You may also want to evaluate your plans for the end of the year and determine whether major transactions can be put off until 2018. It is unlikely that tax reforms would be retroactive, even if they are passed in the fall. Delaying major transactions can help ensure that you capitalize on lower corporate and individual tax rates.

Going into year-end planning, it is important to stay flexible. Consulting with a tax advisor proactively can help you create a strategy to take advantage of tax savings opportunities.

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Moving Boldly and Decisively Through Unpredictable Times

THE near-daily presence of words like "chaos" and "uncertainty" in political headlines may make for compelling television and click-worthy articles. But they also don't help to create an ideal environment for many businesses to thrive.

Typically with any administration change, there is a call to action for business leaders who are concerned about where they see growth and opportunity and where there may be significant risk. However, it's understandable that there could be more apprehension within the business community surrounding an administration that ran on a platform of disrupting business as usual, when it comes to national politics.

Business leaders may no longer be able to rely solely on past patterns as a guide to future possibilities when change feels unprecedented. Exploring a broad range of outcomes through scenario planning or related processes may help to combat the tendency to mistake the unfamiliar for the impossible.

In this regard, it can be helpful to consider what from the campaign may actually result in new policy, how global trade dynamics may change and how new policies might drive government spending and investment.

Leaders that formulate sound analysis of these questions could find themselves better positioned to succeed in tumultuous times. There may be opportunities for growth for organizations that can identify and take advantage of circumstances more quickly than others. When sudden and unexpected change occurs, there are often two dominant responses: Denial and paralysis. Both are natural tendencies, but they likely will do nothing to help a company gain or maintain competitive advantage.

Businesses that can quickly mobilize may find more opportunities for upside. Organizations that can move beyond denial and paralysis, recognize the many variables in play, and develop a plan of attack could be better positioned. Organizations that sit on the sidelines may see opportunity pass them by.

This is where bold, decisive leadership can play a huge role. It's often easier to hesitate to watch and to wait, than weigh the risks of acting now versus waiting for clarity. But there's never likely going to be a perfect data set that can inform the right decisions, and navigating imperfect information is not new for many boards or organizations. Leaders who act decisively are often the ones who will succeed.

They can no longer afford to take anything for granted because circumstances can change instantaneously and with little warning. This upheaval can upend the strategies they have in place. They should consider building their capabilities to anticipate, adapt, maneuver, make risk-informed decisions, and adjust course as needed to help their organizations become more resilient. They should look to develop scenario planning, simulations, and other tools readily at their disposal to support and accelerate this process.

Leaders who can assess risk can take a much more dynamic view and continuously track the changes going on around them that would affect the future of their organizations. But this likely isn't enough for the kind of change that defies the models or has

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no precedent.

Scanning, evaluating and adapting to risk should typically be key parts of a business strategy. Executives should consider challenging their assumptions about industry disruptors and think in a broader context than their immediate environment because nothing happens in a vacuum.

The broader lesson: Geopolitical, geo-economic, and international issues beyond our control can suddenly disrupt conditions that had previously seemed like safe bets, and the commonly accepted conditions in which leaders make decisions on how to compete and win in the marketplace can shift in abrupt and unexpected ways.

Unexpected, unpredictable and often unprecedented actions seem to be emanating from Washington at speeds even those who've been quick to adapt in the digital age could find difficult to anticipate. It may seem that the only predictable aspect of the near-term future is unpredictability. It is the leaders who embrace this uncertainty and aren't frozen in place by it that will likely have their organizations best positioned to not only ride out this turbulence but prosper in it.

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Doing Business in LA: Current Challenges and Potential Opportunities

LOS Angeles presents a complex business environment, with challenges consistent with other U.S. cities, but organizations must also contend with some unique issues. LA is a vibrant city with vast opportunities because of extensive, talented resources. The economy is growing and thriving, with private equity groups actively seeking investments and businesses exploring expansion opportunities.

While LA is the country's second largest city, with many large companies, it is also an established middle market business hub with growing companies driving the local economy. In LA and nationwide, middle market companies are very confident, as demonstrated in RSM's Middle Market Business Index, which is developed in conjunction with the U.S. Chamber of Commerce. In fact, our most recent survey found the highest level of business confidence in the history of the quarterly report.

Generally, LA business owners are cautiously optimistic, eyeing potential tax reform and infrastructure investments that could have a tremendous impact on middle market companies. Businesses have cut expenses as much as possible, and most are taking a wait-and-see approach before initiating any new investments.

One significant measure for the Los Angeles economy is a possible tax holiday on repatriating money from overseas. Many Los Angeles-based companies have operations and finances overseas, and bringing that money back to the United States under some sort of tax holiday would be a major windfall for Southern California, creating the potential for new investment opportunities and infrastructure improvements.

Another reason for business optimism is Mayor Eric Garcetti's pro-business stance. Mayor Garcetti has developed a business-friendly environment, attracting new industries and encouraging startups and middle market companies to establish a foundation in the city. Through federal tax reform, potential subsequent state tax reform and the city's evolving business climate, local companies have reason for continued confidence.

Unfortunately, Los Angeles presents challenges that can pressure middle market businesses. LA is not a tax friendly business environment, with one of the highest state taxes in the nation, as well as an additional city business tax and more extensive environmental requirements than in most states.

The high cost of housing also drives some talented people away. Many employees leave the area, or move away from the city and increase their commute time. At RSM, we also face that challenge, and counter it with flexible work options, including telecommuting.

Despite those challenges, LA remains an attractive destination for employees and businesses. People want to live in LA because of the weather and culture, and will pay a premium for that quality of life. California's strong education system enables companies to leverage the region's vast resources for qualified personnel, from highly educated technical workers to

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manufacturing employees.

From an accounting perspective, LA companies face challenges to hire and retain the right employees. The market is highly competitive because the days of accounting generalists are over, and skills are portable. To be successful, our professionals must have specific experience and know more than just the debits and credits of accounting. Additional perspective is necessary to understand industry issues, implement best practices and initiate discussions that are relevant to our clients.

At RSM, we go to market by industry, so we understand your specific operational challenges and regulatory requirements that are specific to your business. To ensure we have the appropriate people with the right industry skill sets, we developed an industry program with formal firmwide training and national industry leaders who administer learning initiatives.

RSM's LA office has nearly doubled in size over the last three years, keeping pace with local business growth and industry needs. In addition to internal training, we hired partners from other firms and transferred resources from other RSM offices with skills that align with the LA market. For example, LA is the country's second-largest technology market and is growing rapidly. Therefore, RSM has brought additional technology professionals to the area and has developed training programs for our existing professionals to meet demand.

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