ACCOUNTING ROUNDTABLE

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The fiscal landscape in the Valley is as complex a discussion as ever. To provide an overview of what it all means, what we can expect next, and how best to get an upper hand on your business accounting needs, the San Fernando Valley Business Journal turned to some of the leading accountants in the region. These experts share their assessments regarding the current state of business accounting and the various trends that they have been observing, and in some cases, helping to drive. Below is a series of questions the Business Journal posed to these financial stewards of the Valley and the unique responses they provided – offering a glimpse into the state of business accounting in 2015 – from the perspectives of those in the trenches delivering financial advice and leadership to the businesses of our unique region today.

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'The most significant change in business over the last decade is technology. Technology eliminates the need for double or triple entry systems; reducing the need to file large amounts of paper work. Now data can be stored virtually and accessed instantly. Technology has enabled smaller companies to compete with larger enterprises by leveraging technology to handle a global customer base.'

DREW GREY

'If you look at highly compensated individuals in a corporate structure or a flow-through entity, their personal income tax burden in California has grown dramatically, so they're looking to transaction or exit in the next 10 years. It makes sense for them to relocate to a place like Texas, where there's a lower corporate burden and no individual state income tax.'

TODD VAN DER WEL

◆ What are the fiscal pros and cons to doing business in California, compared with other states?

Van der Wel: If you look at highly compensated individuals in a corporate structure or a flow-through entity, their personal income tax burden in California has grown dramatically, so they're looking to transaction or exit in the next 10 years. It makes sense for them to relocate to a place like Texas, where there's a lower corporate burden and no individual state income tax. Also, the operating environment in California is very litigious, and it's difficult to manage your workforce in a place that's very pro-employee versus pro-business.

◆ Have you been observing any new, positive business trends?

Eisenberg: Yes, our clients appear to be more profitable for 2014 and cautiously optimistic for 2015. Many are looking to grow slowly in 2015 and 2016. Some are starting to hire more; some are trying to expand products or markets; some are gingerly pushing up profit margins. Retail landlords are still seeing higher vacancy rates than they would like. More and more businesses are using the internet to send invoices and make payments to their vendors. Record keeping can become more difficult when everything is on the computer, so we have been encouraging our clients to upgrade their backup and record retention systems as well as their computer systems. Businesses that do not upgrade their backup and record retention systems or upgrade their computers risk losing information or the ability to find the supporting documents for IRS audits or customer's invoicing questions.

Arutti: We have seen top revenue growth and increased bottom line profits for many clients among a number of industries. Our clients feel that the higher profits will be sustainable for years to come and that's not a one-year abnormality. We also have seen an increase in M&A activity over the past year, specifically in the tech industry. We are seeing very high multiples as the completion intensifies and sellers are willing to hold off for a better offer.

Grey: The most significant change in business over the last decade is technology. Technology eliminates the need for double or triple entry systems; reducing the need to file large amounts of paper work. Now data can be stored virtually and accessed instantly. Technology has enabled smaller companies to compete with larger enterprises by leveraging technology to handle a global customer base. The advent of social media has enabled businesses an easy way to learn about their customers and target them more effectively. Also, businesses have the opportunity to integrate technology into their decision processes resulting in faster and more comprehensive data analysis.

◆ How are the budget cutbacks going to affect your dealings with the IRS this year?

Arutti: For the most part we expect that IRS will process the tax returns in a relatively timely manner and offer the same essential services as in the past. With the budget cuts, IRS will likely cut the number of audits they perform and will most likely focus even more this year on tax returns that their system flags as tax return with a high chance of potential misstatement. We will likely see longer wait times for the IRS call centers, just when you thought that was impossible.

Eisenberg: Budget cuts will have a severe impact on both taxpayers and professionals. The IRS is understaffed and overworked. That coupled with the complexities of the tax code and the agency's new responsibilities regarding the Affordable Care Act (ACA) will make the ability to contact the IRS to get questions answered or issued resolved very difficult, if not impossible. Furthermore, these budget cuts could put pressure on the agency in its attempt to fight tax and ID fraud. This is a major issue that needs as much attention as possible. Finally, the cuts will lower the IRS's ability to be on top of its enforcement responsibilities. With a lower risk of audit, taxpayer's may potentially be more lax in their recordkeeping, which will make our job of tax preparing and compliance more difficult.

◆ What federal/state regulations have the most significant impact on your clients' business?

Arutti: Although the new healthcare regulations affected many businesses, we believe that the recently passed regulations regarding deduction and capitalization of expenditures related to tangible property will have a big impact on businesses for 2014 and going forward. Some label it as "the most comprehensive change to the tax law since 1986." The new regulations narrow the leeway companies had when deciding on fixed asset capitalization and expensing of certain costs. Although the "playing field" got smaller, there were several provisions of these new regulations that will benefit some companies, in particular companies in the real estate business and companies with significant leasehold improvements. IRS is allowing these changes be made retroactively, but they must be made on the 2014 tax return. Businesses that miss out on this opportunity, this tax filing season, will possibly have to wait a long time

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'High earning clients find themselves paying 57% tax at the top bracket. Our clients realize the need for tax planning more than ever and we have been working diligently with them on minimizing taxes. The key recommendations have been advising clients on how to maximize their deductions, which include concepts like accelerating expenses, taking capital losses on losing stocks and deferring income to future years.'

STAN ARUTTI

'The crunch of tax season is something that we and our families have become used to over the many years we have practiced. They know we will be working a lot of long and stressful days. Eating right, taking breaks, and getting exercise helps tremendously in keeping my energy and sharpness up. Keeping a good disposition also helps a lot. Staying optimistic and having a good outlook helps reduce stress.'

MICHAEL M. EISENBERG

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to recoup the savings and potentially miss out on some saving opportunities forever.

◆ How has the increase in income tax rates changed income tax planning for your clients?

Grey: The increases in income tax rates have caused our clients to place a greater value on tax planning. We are spending more time finding methods to minimize taxes through deferral of income, acceleration of deductions, and identification of refundable credits. An example of some of the techniques our clients have utilized are Research and Development Credit Studies, Cost Segregation Studies for existing or current purchases of properties, using the new repair regulations, formation of Captive Insurance Companies, utilization of Interest Charge Domestic International Sales Corporations, Domestic Sales Corporations, expanded planning for pension utilizing defined benefit plans, and the use of tax deferred exchanges for sales of assets with significant gain. At SRG, we carefully analyze the tax laws to identify responsible reporting positions that minimize our clients' tax paid to the Internal Revenue Service and the Franchise Tax Board.

Eisenberg: Increased tax rates and the complexities of the tax law have made tax planning much more complicated and more important than ever. It is no longer an option to simply say you held an asset for more than a year and therefore it is okay to sell it now and incur a lower capital gains rate. By planning the timing of income producing transactions and thus helping the client stay under specific adjusted gross income levels, you can help them minimize or avoid the ramifications of the new 3.8% net investment tax on such passive items as rents, royalties, interest, dividends and capital gains. You can also help a client lower their overall tax obligation by working with them and their estate attorney in the creation of gift giving opportunities to children or charities. A CPA's role in this area and their knowledge and experience with the new tax laws will be extremely helpful in this endeavor.

Arutti: Between the increases in federal tax brackets, the addition of the 3.8% tax on investment income, the .9% payroll Medicare tax and the increase in California income taxes over the past several years, high earning clients find themselves paying 57% tax at the top bracket. Our clients realize the need for tax planning more than ever and we have been working diligently with them on minimizing taxes. The key recommendations have been advising clients on how to maximize their deductions, which include concepts like accelerating expenses, taking capital losses on losing stocks and deferring income to future years.

◆ Do you expect your tax preparation fees to increase this year and if so, why?

Eisenberg: Yes, fees are going up. CPA's are spending a lot more time in Continuing Education classes due to the Affordable Care Act (ACA) and the new "repairs and maintenance" regulations. The increased complexity in compliance requires more time being spent on business tax returns. Congress' last minute changes and renewal of expiring laws also causes CPA's to spend more time and thought on each tax return. Even with the use of sophisticated tax preparation software the preparer needs to be diligent that all the thousands of pages of tax law and regulations are being applied properly to each tax return. In addition our rents are increasing, our compliance with ACA for our employees goes up, increasing employee salaries, increased insurance costs, and expanded continuing education forces our big cost items to increase thus necessitating fee increases.

◆ How do you handle the crunch of tax season? Do you hire additional staff and/or does your staff work overtime?

Eisenberg: The crunch of tax season is something that we and our families have become used to over the many years we have practiced. They know we will be working a lot of long and stressful days. Eating right, taking breaks, and getting exercise helps tremendously in keeping my energy and sharpness up. Keeping a good disposition also helps a lot. Staying optimistic and having a good outlook helps reduce stress. Meeting with clients and having that social interaction is great for reducing the blood pressure. Yes, we hire additional part time professional staff and require the administrative staff to work overtime. All of the professional staff works 6 days a week and evenings. They know "tax season" means a lot of long days and high intensity work. We bring in dinner several days a week from different places. We now have a massage therapist come in each week, and we try to inject some humor into each day.

Arutti: We hire seasonal employees and ask our staff accountants to work overtime. Although overtime is expected, we try to maintain a culture with a good work/life balance. One example of that, is we let our staff take additional time off after April if they worked over a certain number of hours during tax season.

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Thinking Beyond The Books

"Your business is **more than just numbers.**

That's why we're **more than just accountants.**"

Drew Grey, CPA
Partner, SRG, LLP

SRG ADVANTAGE™

Some clients see us as excellent CPAs who are trusted business advisors. Others see us as trusted business advisors who happen to be great accountants. Either way, SRG is a unique team of professionals with one goal in mind: helping clients plan for and achieve their financial goals. We call it the SRG Advantage™.

We find ways to reduce taxes without impacting the financial statement income and transfer of wealth, thereby, reducing estate taxes and protecting assets from creditors as a result of the proper structure. We strive to increase our clients' net worth by retaining more cash to invest.

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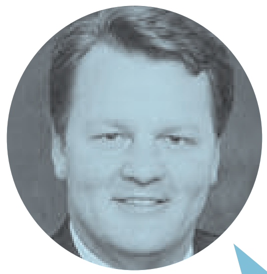
'It is essential that our clients monitor their cash flow. We assist clients in developing cash reporting and forecasting models; providing a daily pulse on their business and projections of future cash needs. At SRG, we strongly urge our clients to develop effective financial and cash forecasting that are updated daily.'

DREW GREY



'There's always a desire to reduce taxable income, particularly for private companies set up as S corporations or another kind of flow-through entity. But I think good companies—good CFOs—know how to balance that desire appropriately. They can meet their banking needs and continue growing while looking to their advisors to help reduce their tax burden.'

TODD VAN DER WEL

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◆ What advice do you give your clients when it comes to estate planning?

Grey: We advise all our clients to have updated Wills and Revocable Trusts. The estate tax rate for 2015 is 40% on the value in excess of $5,430,000 per spouse. It is important to preserve the step up in basis upon death to avoid income tax. Clients who have estates that exceed the exemption amount need a plan that meets their living requirements. We advise clients to retain cash, bonds and stocks to utilize the exemption to avoid estate and income taxes. We suggest that clients transfer their principal residence and or vacation homes, establish family entities to transfer minority interests at discounted valuations, transfer assets via other complex trusts and or sales of assets to a grantor trust to freeze the future appreciation. We use charitable trusts and foundations for certain clients. One of the ancillary benefits of an effective estate plan is asset protection.

◆ Have revisions to state tax rules changed how you approach estate planning?

Van der Wel: The newly permanent status of the estate tax rules hasn't changed very much about how we approach estate planning now versus in 2012, because those laws could still be changed at any time by congressional action. One area where we are seeing change is regarding the lifetime exemption, $5 million for individuals and $10 million per couple (adjusted each year for inflation), because it means couples can transfer a significant amount of their wealth to their loved ones. The danger is actually that they give away too great a percentage too soon—so one thing we're seeing more of is clients developing financial plans prior to gifting, making sure they can truly afford to give the assets and amounts they'd like to give. The priority for us and for them needs to be on taking care of themselves during their lifetime, then on gifting to others.

◆ How is private equity vital to the Southland's business community thriving?

Arutti: Private Equity firms have become a better alternative to a bank loan especially for the small business. Some of our clients are still struggling with getting loans for growth and expansion purposes and are finding the opportunities private equity firms offer to be a viable option to support their goals.

◆ Have you seen a change in the way your clients monitor cash flow and what are some examples you can share?

Grey: It is essential that our clients monitor their cash flow. We assist clients in developing cash reporting and forecasting models; providing a daily pulse on their business and projections of future cash needs. An example is one of our clients provides a daily cash position, estimates the deposits and checks clearing for the week and updates their weekly, monthly, and quarterly cash projections to determine the future needs of their business. The projections are updated bi-monthly with sales backlog reports and updates of any changes in costs. It is important for clients to plan for the short term and long term. At SRG, we strongly urge our clients to develop effective financial and cash forecasting that are updated daily.

◆ How has international commerce impacted your local client businesses?

Van der Wel: The vast majority of our opportunities with new and existing clients include international operations of some kind, whether it's sourcing products from, selling products to, or opening manufacturing facilities in other countries. The marketplace has driven us to increase our international capabilities, so we've been very active in Praxity, aisbl, an international alliance of independent accounting firms that operates in more than 95 countries and territories around the globe. This gives our clients access to trusted in-country resources in the major overseas markets where they conduct business.

◆ How are your clients balancing the importance of providing strong earnings for banking needs versus reducing the amount of tax paid to the Federal and State governments?

Eisenberg: There are still many accounting differences between financial P&L's and tax P&L's. Some of the more obvious ones are the more rapid (or instant) depreciation methods for tax versus a longer write off period for financial accounting and various credits (i.e. R&D Credits, etc.) that reduce the tax without reducing the taxable income. Sometimes clients have no choice, they must report higher taxable income (and pay more tax) in order to have higher financial income. This causes the effective cost of borrowing to be much higher than just the interest rate. Also the use of bonus salaries and pension plan contributions (which can be somewhat optional) can be explained to the banker when net profits are low.

Van der Wel: There's always a desire to reduce taxable income, particularly for private companies set up as S corporations or another kind of flow-through entity. But I think good companies—good CFOs—know how to balance that desire appropriately. They can meet their banking needs and continue growing while looking to their advisors to help reduce their tax burden. Paying tax in and of itself isn't a bad thing—it means you're making money. And remember that banks aren't looking just at earnings but at overall structure: how much equity is in the company, how stable it's been, how many years it's been in business. A good CFO will manage those covenant issues, and a good bank will team with that company to make sure they're on the same page.

Grey: Clients preparing financial statements for financial institutions are challenged with balancing the reduction of federal and state taxes and reporting strong earnings; which helps maintain or increase their credit facilities. We have developed effective strategies to emancipate the clients' financial statements from their tax reporting. The financial institutions require an accrual based financial statement; while the tax law provides for significant differences from accrual accounting. This can yield lower taxable income while not impacting the accrual based EDITDA of the company. We evaluate each company to identify areas where the financial statement and tax reporting may be separated by applying different year-ends and methods of accounting. At SRG, we use the GAAP and tax rules to our clients' advantage while maintaining integrity in all aspects of our reporting.

◆ How are you handling the regulatory issues associated with running a business in LA County?

Van der Wel: Like many accounting firms, our first priority is on safety—so we take a pretty conservative approach to our employee policies and procedures. The other issue that comes up is the additional tax burden we incur simply by opening an office location within LA County. That's something that figures into our business decisions as well.

◆ How should companies evaluate the effectiveness of their accounting firm?

Arutti: Most companies should measure effectiveness by how well their accounting firm meets their goals. Most clients have very clear goals while others need help developing them. We do not measure success by the outcome of a single transaction or project, but rather how well the cumulative results of the projects, interactions with the client and advice we give meet their needs.

Van der Wel: The bottom line is if your accountant isn't on the short list of people you'd call for advice—whether it's about a transaction, a change in your business, or something else—then they're probably not earning their place in your business. You should be able to look at your accounting firm as an extension of your team, someone who's there helping your business grow and develop.

Grey: A client needs to evaluate their goals when hiring a CPA firm. Many clients are seeking a low cost provider who can prepare accurate financials statements and/or tax returns. Many clients are looking for much more. The client needs to perform a cost benefit analysis. The effectiveness of a CPA firm is dependent on the benefits exceeding the costs. At SRG, we serve clients who want more than an accountant. Some of the benefits include tax minimization, financial statement optimization, obtaining debt or capital, and strategic business consulting to assist in maximizing profits.

Eisenberg: Companies can evaluate the effectiveness of their accounting firm using a number of items. The first is communication. Do you have an open and on-going line of communication with your CPA. Is he or she responsive to your questions. Does your professional get back to you within a reasonable amount of time. Are your questions, issues and concerns being answered in a manner that you understand and that makes sense to you. The second item that a client can use to evaluate their accounting firm: are your projects being completed in a timely manner. If your projects are constantly getting back to you at the last

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'The best method to use for creating a successful and valuable relationship between a client and their CPA is to use the team approach. Both you and the CPA bring different strengths to this working relationship. The client knows the uniqueness of their business. The CPA has the knowledge and skills in the areas of finance, taxes and business planning.'
MICHAEL M. EISENBERG

'We are often asked for a referral source in other key business areas such as Investment Advisors, Attorneys, Real Estate and Healthcare professionals. Touching base with our clients on a proactive and regular basis helps us maintain our trusted advisor relationship. We also like to share news articles with our clients that we find relevant to their business to make sure they are aware of the current trends and issues that impacts their business.'
STAN ARUTTI

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minute, you need to communicate your concerns regarding this to discover if the problem is on your end or the accountant's. Your accounting firm should be working with your business staff to maintain the highest level of accuracy to ensure your success. For individuals, your CPA should be communicating with your Estate Attorney, investment advisors, insurance brokers and any other professional that are important in your stage of life to provide you with all of the life planning needs. Third, is your CPA being proactive with you. Are they reaching out to you to discuss issues that are important to you and the on-going operations of your business or personal situation. Many clients do not utilize or take advantage of the skills and knowledge that your CPA firm can offer. Reach out to your CPA any time you have a change in your business or personal situation that can impact your financial goals.

◆ How do you keep up to date on issues that impact your clients?

Arutti: Staying connected with them. We are often asked for a referral source in other key business areas such as Investment Advisors, Attorney's, Real Estate and Healthcare professionals. Touching base with our clients on a proactive and regular basis helps us maintain our trusted advisor relationship. We also like to share news articles with our clients that we find relevant to their business to make sure they are aware of the current trends and issues that impacts their business.

Van der Wel: We certainly look to our memberships in industry organizations for information and do a great deal of industry-specific training and development for our CPAs. But we also do our own research on macroeconomic conditions and industry issues so that we know what's happening and how we can address our clients' challenges proactively and effectively.

◆ What keeps your clients up at night in 2015?

Van der Wel: The economy—still. We're hearing that the economy is healthy again, but it seems not everyone—our clients included—is buying into that notion. Regulation is another hot button. Debt, health care reform, the government's operations. Those are the things that keep our clients up at night, and you'll notice none of them are really under their control.

◆ What is the best formula for creating a successful and valuable relationship between you and you client?

Grey: Providing significant value on a consistent basis is the best formula for creating a successful relationship with clients. It is essential for us to identify the needs of clients and develop a plan to achieve them. Many of our clients desire services, such as tax minimization, financial statement optimization, assistance with finding debt or capital for their businesses, and increasing their credit facilities. For our high net worth individuals, they typically value an effective estate plan that reduces their estate taxes while maintaining control. An ancillary benefit of an effective estate plan is asset protection which some of our clients appreciate. Whether a client needs strategic business consulting or other services, it is imperative for the CPA to recognize these needs and deliver cost effective and quality services.

Van der Wel: The first and most important element is communication. It's only through honest dialogue that we can understand what our clients need and what their challenges are. We have to make sure we're seeing the whole story—which means investing time and building a sense of trust. Clients don't want an advisor who's out to sell them services; they want help growing and becoming stronger in their marketplace. So we always keep in mind that our role is to help our clients meet their objectives, never our own. We can be successful only when they're successful.

Eisenberg: The best method to use for creating a successful and valuable relationship between a client and their CPA is to use the team approach. Both you and the CPA bring different strengths to this working relationship. The client knows the uniqueness of their business. The CPA has the knowledge and skills in the areas of finance, taxes and business planning. By working together during the entire year, not just at year end or tax time, these two components have the ability to achieve an effective outcome that will lead to a long lasting winning formula. For more helpful tips, go to the AICPA website www.cpapowered.org and see " secrets to build a better business." You can also visit www.CalCPA.org and look under public resources (Good4business) to find additional helpful ways to build your business by working with your CPA.