# STATE OF ACCOUNTING

## POINTS OF VIEW FROM THE ACCOUNTING LEADERS' DESKS


As the financial landscape continues to shift and adapt to all that continues to change in our world, 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 leadership of some of the top 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 2018 – from the perspectives of those delivering financial advice and leadership to the businesses of our region today.

STATE OF ACCOUNTING

# Addressing Talent Challenges to Capitalize on Growth Opportunity

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Business leaders find themselves now nearly halfway through an administration that ran on a platform of political disruption. Through that course of time, several new policies were introduced. Significant decisions on restricting global, multilateral trade agreements and a major overhaul of the U.S. tax code unlike anything businesses had seen in decades introduced uncertainty as well as opportunity as leaders worked to position business for success in the years to come.

When facing uncertainty and disruption, business leaders who act decisively with a calculated yet nimble plan forward can be well positioned to take advantage of emerging opportunities while mitigating risk. It's this management approach, among many other market factors, that has helped contribute to business growth in the greater Los Angeles area.

Historically the epicenter for the business of entertainment, L.A. has experienced growth across business sectors, mostly notably technology. Nicknamed "Silicon Beach," the coastal area north of Los Angeles airport is currently the third largest technology ecosystem in the United States, according to a Bixel Exchange report on the L.A. tech talent pipeline. Attracting and fostering innovation, the market has gained a reputation as one rich with opportunity for both young and established technology companies. Countless technology incubators, accelerators and tech corporations now call the Los Angeles area home. L.A. ranks number three nationally, in terms of the number of companies placed on Deloitte's Technology Fast 500 each of the last two years.

With industry growth comes uncertainty and challenges. Local business leaders need to quickly address the technology skills gap in the market in order to help sustain the current growth trajectory. Leaders who address the challenge head on may have the best opportunity to capitalize on growth. A thoughtful evaluation of the market factors that have contributed to the technology skills gap can uncover the factors most relevant to specific a business, enabling leaders to build a framework to help solve the issue.

Broadly speaking there are a few approaches to help close the technology skills gap: 1) looking within to align current talent with need and 2) supporting development of the external talent pool. Leaders should not overlook the expertise and talent that currently exists within their corporate walls. Large technology companies with a new or increased presence in L.A. that employ hundreds or thousands of tech employees around the world may already have access to the needed resources. However, recruiting talent from within often requires procedural or cultural changes to link disparate business functions such as strategy and talent management. Business leaders might consider breaking down barriers to internal mobility by fostering a culture where people are encouraged and expected to look internally for professional growth and new challenges.

Understanding strategies to increase the technology talent in L.A. and recognizing the value of developing existing talent involves a deep commitment to the community's technology ecosystem. By joining a local chamber of commerce, can encourage networking and give businesses a voice on local business issues including the talent shortage. In addition, participating in talent development programs, through academic institutions and private or public organizations, has the potential to spur sustained interest in technology among students and expand the local talent pool exponentially.

Leaders that spearhead participation in coalitions of educational institutions and employers dedicated to developing qualified, local talent and decisively work to remove internal barriers to finding existing talent promise to help Los Angeles continue its unprecedented growth and success in the tech industry. The investment of time and resources in both the community and in individual businesses can help position the city to continue to serve as a launch pad for both new and established tech companies.

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# How Technology and Innovation are Driving the Future of Accounting

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Great things happen when people collaborate

When you ask most people which profession is likely to transform the most in the future you may not expect to hear them answer "accounting."

The accounting profession is on the cusp of change like never seen before. If you listen to Barry Melancon, the head of the American Institute of Certified Public Accountants (AICPA), he believes the profession will change beyond recognition in the next five years. I am not alone in my agreement. Barry recently stated, "If we are willing to go beyond, to push on beyond the perceptions of what we do, we can create a profession that's aligned with where the world is headed."

What's driving this? The answer is technology. It is fundamentally changing how our clients do business. Our clients are consumers of information, and technology has enabled all of us to gain access to knowledge that was once considered off limits, or at least more difficult to acquire.

Some leaders in the profession have predicted robotics would eliminate or automate up to 40 percent of basic accounting work by 2020. Even a more conservative estimate of that percentage will greatly impact how the profession will change, and with it, the role and skill set of what we now call an accountant.

The proliferation of software applications has automated and improved many of the functions within a company's financial reporting system. Technology creates people and process efficiencies. Most technology-enabled accounting departments are run by fewer people, and those people can often have less formal training and education than historically required. This can be a plus for companies in achieving certain kinds of savings, but the risk is having accounting teams with under-qualified resources. The role accountants need to play is not solely as technical experts, but also advisors in helping our clients interpret and action on data we collectively analyze to further results.

Information (both tax and GAAP) that was once held in research libraries at firms and gained through years of experience is now freely available on the Internet. That is a great thing to democratize knowledge. But again it requires the right ability to analyze and lead based on the accurate reading of today's "big data."

The sheer volume of data now available from the simplest of accounting systems provides insights that were not long ago only available to the most sophisticated companies. An abundance of data sounds like a good thing, but it's easy to get lost in the weeds unless there is clear direction on measures. Setting business objectives around the right KPIs to manage and monitor is a success game-changer. Firms of today and tomorrow must be prepared to coach and guide clients in these success metrics.

These changes require CPAs to adapt to maintain and improve their clients' experience. CPA firms now must be equipped with more than just technical skills to maintain their role as trusted advisors. One of our clients in the food and beverage sector commented: "Like most companies, we are unique in our processes, requirements, and business environment. We rely on our accounting firm to focus on what really matters and allow us to run our business while providing strategic oversight that positions our company for continued growth."

To achieve that kind of trust with a client demands skills that go beyond compliance. Technical skills are considered table stakes, but other skills will be considered non-negotiable for accountants to keep pace with the demands of the future.

How can firms define those skills? They must:

- **Be data masters.** They need to understand data architecture. How to mine it, provide expert analysis and be able to easily client assimilate data into audit and tax services for them to be more efficient and precise
- **Go beyond the labels of tax accountants and auditors.** They need to also be able to think like system engineers and marketers and human resource experts to provide outsourced expertise to clients.
- **Rethink their talent strategy.** Recruiting and staff development for many entry-level functions will likely be replaced by technology and automation.
- **Be constant pioneers of change.** Internally within their firms, and externally in serving their clients, accountants of the future must embrace and advocate for innovation and change.
- **Co-author the client success story.** The accountant of the future will not only help clients interpret and navigate their current business impact, but will effectively help define and guide how clients can pave the journey ahead.

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# *State of Accounting: Entity Choice a Hot Topic After Tax Reform*

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The Tax Cuts and Jobs Act (TCJA) was signed into law by President Trump in late December 2017. Also known as Tax Reform, the TCJA has created quite a stir in the news then and it continues today. There's no doubt the law made significant changes to both business and personal income taxes but for companies, one provision may have the most substantial long-term impact — the cut in the highest corporate tax rate from 35% to 21% and how it might influence entity selection.

For years now, the trend in entity selection has been toward partnerships and away from corporations; this is especially true for privately-held companies. For example, limited liability companies (LLCs), which generally have the option to elect corporate status or not, have, over the years, overwhelmingly preferred to be treated as partnerships for tax purposes. However, that trend may now be slowing or coming to a halt.

Subject to the type of business and the activity level of its owners, the corporate form of entity may now yield the highest tax savings for both owners and company. For example, if a business is considered "passive" to the owners, depending on the income level of the company and tax bracket of the owners, the difference in tax rates could be significant. Contingent upon the type of business, a pass-through entity, like a partnership, could yield federal income tax rates of more than 40% after the 3.8% net investment income tax. Compare that to the new highest federal corporate income tax rate of 21%, and

> **Entity selection under Tax Reform is a crucial element to address. Depending on circumstances and the type of business, a change in entity could yield tangible tax savings over the long haul.**

it becomes clear why the trend toward partnerships may be over.

The law tries to make up for some of the difference in tax rates, such as a new 20% deduction for "qualified business income," which reduces that amount of taxable pass-through income. But not all business types qualify for this deduction and since the deduction is actually taken on an owner's personal income tax return, this deduction is not a permanent change to the tax law. The sunset provisions added to individual income tax changes under Tax Reform mean that in 10 years this deduction could be gone.

These potential outcomes sound positive for corporations and their shareholders, but like most things related to the Internal Revenue Code, the devil is in the details. It's important to remember the use of a C-corporation can still result in double-taxation. This typically happens when the corporation pays income tax on its earnings and then declares a dividend to shareholders, but dividends paid are not deductible to a corporation. The shareholder recognizes the dividends received as taxable income creating the double taxation. Of course, there are other ways to get money out of corporations, but a conventional return on investment in the form of a dividend will still result in double taxation. Since the level of dividends impacts how beneficial the C-corporation rates can be, planning before any change is essential. The result may still be advantageous over using a pass-through entity, but it needs to be evaluated before deciding to change.

Another consideration is the potential use of the Section 1202 exemption. Subject to eligibility, this provision of the law allows for preferential treatment on the sale of "qualified small business stock." The result could be the exclusion of 100% of the gain on the sale of the stock. This is another situation that requires substantial planning to ensure that all the requirements are met and could be another reason to consider a switch to the C-corporation form of entity.

Entity selection under Tax Reform is a crucial element to address. Depending on circumstances and the type of business, a change in entity could yield tangible tax savings over the long haul. Whether your company makes a change or not, any decision should involve a detailed modeling and analysis process to determine the best choice for your business. A discussion about how the change might impact other aspects of your business is also vital. No change is easy, so be sure you've done your homework and you are comfortable with all aspects of the change before making the switch.

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# *The Future of the CPA Profession: What Firms Need to Do to Keep Up*

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It's such an amazing but unsettling time to be in our profession. Over the next several years, the accounting industry will look quite different due to technological advances. Many of the things we are doing today will be done significantly different down the road. When I look back over the last 30+ years, there have been lots of changes in our industry, however, it seems like we will experience more unprecedented disruption looking forward.

Technology will change our industry in every way and aspect, including the way we work, the areas we work in, and the people we recruit, hire, and develop.

Audit and tax compliance revenue work will become commoditized. Artificial Intelligence and Blockchain will take away the need for "number crunchers," so we will need to adapt to the changes to be more consultative and less compliance-oriented. Bookkeeping will continue to be automated with seamless integrations between our clients, vendors, and banks so there will be an erosion of fees in that area as well. Almost all service lines in our profession today will be impacted one way or the other by the technology of tomorrow.

So that should mean less pressure to recruit and retain people because they will be replaced by machines, right? To some degree yes, but it will be different and more complex. We will have to re-train ourselves and our seasoned team members to be more proactive and act less like historians. We will hire less young staff, fresh out of school, and hire more experienced, critical thinkers. We will recruit and hire from outside our profession including non-accountants, with specific industry operational experience. We will bring in talent especially from the IT industry. Our historical pyramid labor model will look more like a diamond.

The future of our profession is changing so quickly that smaller CPA firms feel they must merge or sell and retire. They either do not have the resources or the desire to keep up with all the upcoming technological advances, especially near the end of their careers. The disparity between aging partners and accelerated growth in technology will continue to increase the number of mergers and acquisitions transactions seen in this industry for years to come.

Short of getting out of the profession, is there any good news during all this doom and gloom? Absolutely! The good news is that there will be amazing opportunities for those in our profession to leverage innovative technology and continue to find ways to add value to their clients.

It's not rocket science or anything new – adding value starts by spending time with clients, finding out what keeps them up at night and helping them find solutions; all while guiding their companies to become more profitable, so they can reach their financial goals. We must be the problem solvers. Being an expert at preparing tax returns or financial statements is not enough – we have to understand and help clients navigate their industry, help them understand new technologies, give them valuable real-time information, and help them get the right people into their organization. We need to be an integral part of their financial team, to be more consultative, and truly be a trusted advisor.

To transform your organization, consider the following:

• **Hire, develop, and retain the best and brightest people.** Hiring exceptional team members is the answer to just about everything! Again, nothing new, the only variance will be focusing on a new breed of talent: outside industry specialists; people that can lead a new service line, provide significant depth and experience in a certain industry, and those that have a background in technology.

• **Embrace technology in every way.** The top five areas affecting our industry in order of importance are data analytics, artificial intelligence, cybersecurity, continuous auditing, and blockchain. Real-time, meaningful information is what everyone needs, including us! If you're not spending time understanding each of these technologies, you are losing ground and potential opportunities.

• **Developing specialties or niches are more critical now than ever before.** Being consultative and the "expert" will not be commoditized like compliance work, providing value will be most important and generalists will not flourish in the future. Adding new service lines as well as attaining more knowledge in specific industries will be where we find opportunities to grow the profession.

• **Outsourcing is key, especially for smaller firms.** Many firms focus on their core services and simply don't have the time to move into other areas. The problem is that our clients need solutions and if we don't provide solutions, another firm will. If you do not have the resources and cannot hire the expertise – outsource.

We all know the future of the CPA profession is going to change due to technological advances like we have never seen before. It is now up to us to embrace the transformation and help our clients by fulfilling our label as the "trusted advisor."

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