dollars and sense

What Philadelphia's CPAs want you to know about accounting

Compiled by Rebecca Kirkman and Lindsay Eney : Photography by Hannah Chen

It's hard for CEOs to keep track of the many changes in taxes and accounting, but these tricky numbers have serious impacts on your business. Between GAAP changes and advancements in technology – going paperless and embracing cloud systems – the relationship between an accountant and his client is always evolving. With many unknowns on the horizon, a trusted CPA adviser can keep you up to speed and point you in the right direction. SmartCEO brought together 11 of Philadelphia's top CPAs to share what every CEO needs to know – from creating compensation and benefit plans to choosing the right accountant.

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Roundtable experts

Pictured above, left to right.

Sponsor: Darrel German, senior vice president, Philadelphia commercial lending group, TD Bank
Andrew F. LaRosa, managing member, LaRosa & Associates, LLC
Andrew J. Malone, partner, Fesnak and Associates LLP
Jay Weinstein, partner, EisnerAmper
James H. Hamlet, member, Isdaner & Company, LLC
Charles M. Shechtman, managing shareholder, Shechtman Marks Devor PC
Michael G. Horsey, managing partner, Mitchell & Titus LLP
Brian J. Hoffman, partner, CitrinCooperman
Christopher B. Hegarty, partner, CliftonLarsonAllen LLP
Brian J. Gallagher, managing member, GMS Surgent

Paul D. Kinmartin Jr., Philadelphia regional managing partner, ParenteBeard
William P. St. Clair, managing shareholder, St. Clair CPA Solutions
Moderator: Rachel Cieri, managing editor, SmartCEO magazine (not pictured)

Read between the lines

These line items on your financial statement deserve your attention

You monitor your sales and net profits, but there are other figures on your financial documents you should keep an eye on too. Not only is an understanding of your financial statement important for running your business now, but that statement is also what potential buyers and investors will look at first.

Even if you're not currently looking to sell your business, cleaning up financial documents and understanding what figures are used to assess value will help you increase your value in the future.

Your EBITDA, or earnings before interest, taxes, depreciation and amortization, is one of the first numbers buyers will use to determine your potential value in a sale. A product of the leveraged buyout mania of the 1980s, the calculation was used by leveraged buyout lenders to determine a company's ability to service debt. Later, the measurement was used to determine the cash flow of companies with long-lived assets and machinery. Over time, EBITDA became a measurement tool in all industries. The number is a quick way to evaluate a company's ability to pay back debts and provides an estimate of operational cash flow.

The number is calculated by subtracting expenses from revenue, before taxes and interest, and doesn't include amortization and depreciation, what you pay for tangible and intangible assets. Since EBITDA eliminates the effects of financing and accounting decisions, it's a good tool for comparing companies across industries.

Since putting amortization and depreciation charges back into earnings doesn't give a realistic picture of a company's finances, the EBITDA figure must be adjusted. Work with your accountant or CFO to understand what add-backs are made in your EBITDA adjustment, such as your own excess income and unusual or one-time expenses.

EBITDA is just one of several line items on your financial documents you should have on your radar. Our roundtable experts discuss which items are most important to you – and to a potential buyer.

Roundtable experts weigh in:

Which items on a financial statement deserve a CEO's attention?

Gallagher: Sometimes the most important information that a buyer is looking for is not on the balance sheet or the income statement, but embedded in the footnote disclosures. Like customer concentration, that's a big issue.

Hoffman: A CEO needs to have a good CFO and a good CPA in order to navigate those numbers. The CEO doesn't necessarily need to know every single one of them. One key area that is often overlooked is evaluated budget versus actual expenses. It's a great tool for identifying anomalies in a timely fashion – fraud, waste and abuse. That's where the key time is spent for a CEO.

Horsey: The CEO, in conjunction with the CFO, should develop certain metrics consistent with their growth and development. They may not be inherent to a financial statement, but there are certain metrics that facilitate group decision-making.

Gallagher: We recommend a dashboard or flash report, as well. Depending on what business they're in, there are different performance indicators the CEO should be looking at. Beyond the profits and sales, return on investment is a key component.

Kinmartin: Look at the gross margins on a disaggregated product line basis so that the CEO can determine where to make allocation decisions. Also look at leverage – if it's a highly leveraged business, look at where the cash flow is coming from to pay that off.

St. Clair: Buyers want cash flow. If the company's profitable and has good cash flow, they are very salable.

Shechtman: The quality of earnings is what potential buyers are looking for: No abnormality in profits over the last few years, that the business actually has sustainability of their profits and that there's no one vendor or customer that dominates the financial statements.

Hoffman: Buyers are looking for outperformance of industry peers. If you're trying to position yourself for a sale, it's good if your figures are better than your competitors'. Try not to take every last dollar out of the company. Try to retain and plough some money back into the business.

Kinmartin: Looking beyond the financial statements, understand if there are any contingent liabilities or off-balance-sheet liabilities that the buyer needs to be aware of, as well as undervalued assets that could be valuable to the seller. •

CPA Tip: Key numbers

CPAs say to keep an eye on these line items:

Cash flow: Are there reliable trends a potential purchaser can track?

Financial statement notes: Do you know what they are disclosing?

Sales: What is your annual revenue?

Gross profit: How profitable are the different areas of the business?

Capture the [red] flag

"IRS" is probably the most hated acronym in the country, and its best friend, "audit" isn't exactly popular either. But this doesn't have to be a terrifying process, and there are ways to avoid it. There are some simple steps you can take to avoid letting your red flag fly.

Keep business and personal expenses separate. Using a separate business credit card will help keep it straight. Entertainment costs can get especially tricky. Keep in mind that you may only claim 50 percent of entertaining and food expenses as a deduction. Don't let that keep you from spending face time with clients, but be smart about it.

Always report your gross income. Reporting a net income (i.e. an electronic payment with service fees deducted) reduces your taxable income and is a huge red flag. The IRS has found that businesses dealing mostly in cash are more likely to underreport their taxable income. Gas station convenience stores have been known to be one of the most audited businesses for this reason. From transportation companies and hair salons to restaurants and bars, you may be subject to an audit if it appears you aren't reporting all income.

Turn a profit. Of course you want to be profitable, but reporting a loss more than three out of five years will have your red flag waving high. The IRS might think you are writing off a hobby as a business.

Be on time. If you're late on deadlines, your business appears unorganized to the IRS. Be timely on quarterly deadlines and on sending out 1099s to stay in the clear.

Be crystal clear. The IRS does not like miscellaneous deductions. Spell it out for them as clearly as possible.

Keep good company. Just like in grade school, sometimes all you did wrong was hang out with the wrong crowd. If a company you do business with is being audited and your company pops up in the review, an agent may be headed to your door next to make sure any payments were reported.

Audit coverage by company asset size

Assets under $10 million
FY 2008: .95%
FY 2011: 1.02%

Assets $10 million to $50 million
FY 2008: 11.7%
FY 2011: 13.3%

Assets $50 million to $100 million
FY 2008: 11.7%
FY 2011: 18.9%

Source: IRS

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Techno-logic

Upgrading accounting technology makes sense

Is your accountant a "Digital CPA"? The American Institute of CPAs held a Digital CPA conference in late 2012 discussing how technology is changing the relationship between CPAs and their clients. Harnessing the power and integration of new technology available in financial services – especially cloud computing and mobile -- can streamline your accounting processes, help your accountant serve you better and provide you easier access to your company's financial information.

Cloud integration is the most-adopted technology in the tax and accounting profession, according to a 2012 nationwide survey by CCH Group, a leading global provider of tax, accounting and audit information, software and services. Mobile, big data and social media ranked next on the list.

Cloud computing breaks down geographical barriers, facilitates real-time interaction, standardizes workflows, allows for business intelligence reporting and increases efficiency and flexibility.

Whenever technology meets sensitive information, there's an inherent risk. Security and confidentiality are among users' top concerns when it comes to cloud-based accounting services, according to a survey by CPA2Biz, a subsidiary of AICPA, in 2012. When financial data travels across virtual channels, proper security protection must be taken by both the CPA firm and you, the client.

Whether it's going paperless, integrating a cloud system or setting up web-based performance dashboards, our roundtable experts explore the frontier of accounting technology and how it can benefit business owners.

Roundtable experts weigh in:

What new technology can CEOs use to better track and manage their finances?

Hamlet: A lot of our clients get flash reports, where we drill down on the information so they can see a number of months' sales and inventory, the cash position, budget versus actual. They don't need to look at every single item; that would be a waste of their time. They're talented, and they need to focus on growing and running the business.

Gallagher: We mentioned the dashboard – there's a lot of great financial reporting software out there that takes what's in those financial statements and puts it on the dashboard for the CEO to look at. It works with anything from exporting data from QuickBooks right on up to SAP-type models.

Kinmartin: There's a lot of movement toward cloud-based computing. Clients are upgrading to a different financial reporting package, or consolidation package if they're growing and consolidating businesses, to better manage their numbers. They might look to cloud-based computing not only because the technology's cheaper, but also because you get access to experts. I think controls around IT become more and more important, especially with vulnerability to data and the potential implications you could have with your customers and regulators if there was a breach, if it's secure or sensitive data. Not just internally, but externally, CEOs can use tools to monitor what's going on with their competitors, with their range of customers and the marketplace in general so they can be more proactive. •

CPA Tip: Top technology

Consider these tools to trace your targets:

Dashboards and flash reports: Information supplied by your managers is synthesized in real time for immediate analysis.

Cloud computing: It's not only cheaper, but also gives you access to experts.

Go go gadget

How one company capitalized on high-tech accounting

Let's face it – CPAs aren't generally known for being on the brink of the latest technologies. But now that mobile phones and iPads follow us everywhere and multitasking is a part of life, technology is making its way into the accounting world. Many firms are discovering the benefits technology can offer to their processes, employees and clients. Rockville, MD-based payroll and HR solutions provider Payroll Networks, Inc., jumped on the technology bandwagon early and is reaping the benefits. Here are some of the ways technology is creating a new normal at Payroll Networks – and could for you, too.

Going green. Paperless technology isn't only good for the environment; it's more convenient for you too. "We've eliminated paper," says George Whitehouse, co-founder, EVP and chief marketing officer of Payroll Networks. "You used to have to pick up paper and bring it back to the office. Now our services and products can be accessed via the internet anywhere. Some of our clients allow their CPAs to look at a lot of their reports, and it saves time, not having to push those [hard copies] back and forth."

Improving access. Cloud-based systems make accessing files and records easy. When working on-site at your company, cloud technology allows your accountant to access information as easily as if he was at his own desk. "The employee can be outside of the office, and by way of smartphone, iPad or tablet, be able to go in, access the information, record their time and charge it to various projects that they're working on," Whitehouse says. Another technological benefit is remote video training. "A lot of times, it's hard to gather up three or four people, but they don't have to do that. They have the option to do it live via web expert," Whitehouse says. "The traffic in DC is not much fun; companies might opt for having training via the web."

Serving customers. In this time of remote-capture check deposits, FaceTime and constant internet access, we live in an era of instant gratification. "People want things right now, they want them today and they don't want to have to pick up the phone and call people," Whitehouse says. "Our technology allows us to communicate via the internet and our chat program." Though at first technology in the business world seemed to create distance in customer relationships, it can be harnessed to the customer's benefit. "We have an extensive use of chat with our clients," Whitehouse says. "It went from them sending us emails back and forth to now having chat capability, where the client can chat with one of our folks here when they have things they need answered right away."

Reducing risk. Like any new technology, the ease of passing information along virtual channels comes with risk. "We've got multiple security features that include data encryption and authentication of login," Whitehouse says. As risks increase, so does the technology to protect virtual information. "We like to describe it as if you were at a bank – we have the maximum amount of security you can provide." Sending and receiving information is a two-way street, and it's just as important to have security as the client.

Payroll Networks used technology to provide a better experience for their clients and employees. Cloud-based technology is the way of the future, and firms turning a blind eye to the possibilities will be left behind. Consider you how your financial reporting could benefit from these new technologies.

George Whitehouse is co-founder, EVP and chief marketing officer at Rockville, MD-based payroll and HR solutions provider Payroll Networks, Inc.

Crunching the number crunchers

Signs your accountant is underperforming

Do you see your accountant as a trusted adviser, or a as a means to an end – that end being taxes? A good accountant, internally or externally, acts as a partner in your business, calling you with updates on regulations, notifying you of changes and immediately bringing problems or issues to your attention.

As your company grows, you may outgrow your local CPA firm. Most mid- to large-sized businesses can't expect to retain their first firm as the business expands. If you've gone through a period of fast growth, your current firm may no longer be able to provide the services or industry expertise you require.

Here are some areas to assess as you consider moving your accounting services to a new firm:

Specialties: As your company grows, you need a trusted adviser who's on your side. With the ever-changing regulations coming from DC, make sure you have an accountant that specializes in your industry and can keep you abreast of the newest information and prepare you for what's coming down the pipe.

Fees: Some firms bill you by the hour or minute, while others charge a flat fee for certain all-inclusive services. Determine what you need from your accountant and how much communication you expect with them to make a choice about what fee structure fits your company's needs best. Keep in mind the level of service you receive correlates to the price you pay, so don't expect top-of-the-line service and contact with principals from dirt-cheap deals.

Availability: It's up to you how much interaction you want with your CPA firm. If you plan to use your CPA as an adviser, make sure you choose a firm with easy access to managing partners and where your accountant has the time to give you the support you need, whether that's advising when to purchase new equipment or providing extra assistance when you're audited.

If you're not sure whether your accountant's performance is up to par, our experts spell out signs that it may be time to make a change.

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Roundtable experts weigh in:

How can a CEO evaluate his or her relationship with internal or external accountants?

Shechtman: One of the red flags would be how often surprises happen. If surprises are happening often, then something's amiss. A well-managed relationship means plenty of advance notice so you're aware of what's going to happen in the future. That's the role of the accountant; taxes and the financial statement are not the end product.

Horsey: Do you have a lack of confidence in your accountant? Are you hesitant to go to them for advice? If you do, then that's a sign you need to be looking for somebody else. You need to be confident in your ability to go to your advisers when you want to seek valuable information.

LaRosa: I think timeliness of service and promptness are critical. When you start to miss deadlines and not return phone calls, some of the basic things that sometimes get lost in the shuffle are critically important. If you're not getting that timely and professional service – if you do call your CPA and they're not giving you the answers – it's probably time to look for a new CPA.

Hegarty: Getting enough time and attention is certainly a red flag. Accountants change and outgrow some of their clients, and companies change and outgrow their accountants. The time and attention you're getting or not getting from your CPA could be an indicator that you need to talk to other people. There are different fits for different firms in their lifetime, so it's healthy to get to know other accounting firms that are out there and understand what they have to offer.

Hamlet: If you are the one calling the accountant with questions, your accountant should be calling you with ideas. When new legislation comes out, [your accountant] should be figuring out, "Who does this affect client-wise in my firm?" and calling them first. You [might have] started small and you had a great person, but sometimes you just get too large and there are some points of sophistication such that you need somebody a little stronger.

St. Clair: We live by two mottos: If we promise it, we deliver it, and we return all phone calls and emails. Communication – it's a service business. How hard is it to take care of our clients?

Gallagher: We think like business owners instead of like accountants. Most of us are closely held business owners ourselves, and it's important for us to help our clients in their day-to-day issues.

Horsey: There are models that follow the corporate Fortune 500 scenario, where you have more than one accounting firm servicing the needs of an entity. Small businesses are now going the direction of lawyers. Sometimes there's a need for an existing relationship, but sometimes there are other needs. So I see in the future a multi-service concept with respect to servicing small businesses. So you don't have to kick the firm out the door because there are certain things they don't deal with, but there are multiple needs that can be serviced.

Malone: You can go even further with the contact of the partner. You can throw the juniors and the seniors out on the job and they'll have client contact, but ultimately what the client's looking for is partner contact. •

CEO and CPA

Getting the most out of your accounting relationship

True, you hired your CFO and accountant to take care of your finances. But as the CEO, that doesn't mean you should back out of that side of your business. It's still important to be involved, especially when the IRS comes knocking. "CEOs may divorce themselves from the audit process simply because they are unfamiliar with it and they don't understand the value it can add," says Elizabeth S. Gantnier, an audit specialist and president of Stegman & Company.

Be present. "You take out the governance aspect of the CEO, and you're missing a critical element," Gantnier says. The CEO's involvement is central in private companies, since there isn't an external board providing independent governance. "The auditor wants to know that corporate governance is paying attention to internal control," Gantnier says. "If something's misunderstood at the CEO level, the whole organization feels that."

Think about effects. Your influence as a CEO goes beyond the world of audits. Decisions you make affect your finances more than you may realize. Smart business leaders consult their accountants before making any financial decision. "The CEO needs to be more involved in how the contracts he's negotiating have an impact on people's behavior and incentives," Gantnier says.

Involve your accountant. You should treat your accountant as a trusted adviser. "Some decisions at the most basic level have an accounting impact that the CEO may not understand at all," Gantnier says. This is especially important before implementing new employee benefits and compensation, signing a contract that is not an ordinary course of business or attempting to raise capital by bringing in a new investor. "You may have an accounting impact that is exactly the opposite of what you thought," Gantnier says.

Communicate openly. "CEOs sit around and wait for accountants to call. Pick up the phone, these guys should be your right-hand person," Gantnier says. "I think the CEO should have direct conversations with the auditors, without the CFO present, about where their risks lie in the functioning of their financial reporting." It helps if you hear these things straight from the auditor, not through the lens of people in your company. "The CEO may not understand that the budget that was created has also created an incentive for people to mishandle something," says Gantnier.

Your accountant can provide filters and feedback and aid in setting up checks and balances.

Elizabeth S. Gantnier is president at Baltimore-based financial services firm Stegman & Company, P.A. www.stegman.com.

Golden handcuffs

The best benefits to attract and keep your top employees

Coming out of a recession, business leaders are forced to make hard decisions about their employee benefits and compensation plans.

Unlike the drastic cuts of the past couple of years, employers for 2013 have largely chosen to maintain compensation, health and welfare benefits and retirement levels, according to a 2012 study by Verisight, Inc., and McGladrey, LLC, for the American Benefits Institute. More than half of the organizations surveyed have or are considering implementing an increase in employees' contribution to health and welfare expenses. Due to the highly competitive environment, the study found more companies are switching to pay-for-performance compensation, with over 50 percent currently using the model.

Employee stock options provide an alternative to increased compensation. According to the National Center for Employee Ownership, about 36 percent of the workforce owns stock in their employers, a number that has drastically increased over the past few decades.

As part of a compensation package, stock options help attract high-level talent. Once hired, stocks provide an incentive for employees to reach predetermined goals in order to share in the wealth. Vested stock is a tool to retain employees, where a certain percentage of the stocks are released after a predetermined length of employment or after the employee reaches certain productivity goals.

Before entering into employee stock plans, be sure to consult your accountant and your lawyer to determine which of the many plans is best for your company. Our expert panel of CPAs weigh the pros and cons of the many employee benefit options.

Roundtable experts weigh in:

How can a CEO create an attractive compensation and benefit plan that is flexible and cost-effective for the business?

Hoffman: It's important as part of a benefit package to align the company goals and compensation. I think business owners would be willing to pay their top talent more than they already are if that top talent is getting them where the company needs to be. Phantom stock plans and really thoughtful bonus plans are ways to do that.

Kinmartin: There needs to be a good balance between base pay for your role and incentive pay for the contributions your employees make, especially for your higher performers, who may decide to go elsewhere if they aren't being recognized and rewarded financially.

Hegarty: Good companies measure what they treasure. If you want sales, you incent the people who create sales; if you want margin, you incent the people who create margin. Measure what's important to you, and then reward the people in it. If you're not incenting people for the behaviors you want, you may end up with behaviors that you don't want.

Hamlet: With phantom stock, it's essentially an employment agreement. You're not diluting your stock. You're saying, "Here's what the company was worth when you got here. You're very important to us." When they value the company down the road, they get the share in the growth of the company. It's a great incentive for them to stick around. It's more difficult for nonprofits – they have deferred comp plans with 457(b)s and 457(f)s. They don't have to recognize any of that compensation until they take it. That said, it is subject to creditor risk, but they're great plans that we have with a handful of not-for-profits, and we use it to keep good people in place.

> "There needs to be a good balance between base pay and incentive pay, especially for your higher performers."
>
> **Paul D. Kinmartin Jr., ParenteBeard**

Horsey: On the not-for-profits scenario, we've seen people looking at non-compensatory rewards. It's not immediate cash but other types of rewards you provide your key employees in those types of environments: A week away in Aruba, or something to identify the good work you're doing for the organization.

Weinstein: It's important to clearly articulate how the "measure what you treasure" plan is going to work and then consistently apply the plan, not just across people but over a period of time, so people can adapt their behavior.

Shechtman: There are ways to compensate people without it costing you money – making a great culture, a great place to work – whether that's giving people flexible hours or something as mundane as wearing jeans on a Friday. It's not costing money, but it's making a great working environment.

Gallagher: Communication with employees is a common theme. When it's appropriate, we present a detailed compensation and benefits report to their employees. A lot of times those employees don't understand what those benefits are. That statement on an annual basis is quite helpful.

LaRosa: Especially in smaller employers, it's a really good idea. [Employees] don't realize what the costs of benefits are, with respect to healthcare and disability. It will help give them more satisfaction that these costs are being paid on their behalf; you're just not seeing it in your paycheck.

St. Clair: We've been using it for years with our annual reviews. If you're giving good benefits to your employees, there is a cost to that, and they need to be educated. •

CPA Tip:
Phantom stock pros and cons

Pros: Easy to implement; minimal cash-flow impact (beyond upfront legal costs); ties key employees to the company.

Cons: Not very flexible; could result in enriching key employees so much that they retire; subject to creditor risk.