VENDORS BEWARE!
FULFILLMENT BY AMAZON CAN CREATE STATE TAX HEADACHES
Financial institutions should have effective Bank Secrecy Act/Anti-Money Laundering (“BSA/AML”) and Office of Foreign Assets Control (“OFAC”) policies and procedures to manage the risks associated with senior political figures, otherwise known as “politically exposed persons (PEPs).” Under the Federal Financial Institutions Examination Council’s BSA/AML Examination Manual (“FFIEC Manual”), PEPs include:

- Any corporation, business, or other entity that has been formed by, or for the benefit of a PEP.
- The PEP’s “immediate family” which includes parents, siblings, spouse, children, and in-laws.
- The PEP’s “close associates” defined as individuals widely and publicly known to maintain an unusually close relationship with the PEP, and includes persons in the position to conduct substantial domestic and international financial transactions on behalf of the PEP.

The Know Your Customer (“KYC”)/Enhanced Due Diligence (“EDD”) and sanction screening processes are the key opportunities to conduct risk-based due diligence on PEPs, and financial institutions should have adequate processes in place to monitor PEPs for potential suspicious activity. Due diligence should include, but not be limited to:

- Identifying the accountholder and beneficial owner, including the nominal and beneficial owners of companies, trusts, partnerships, private investment companies, or other legal entities that are accountholders.
- Seeking information directly from the account holder and beneficial owner regarding possible PEP status.
- Identifying the accountholder’s and beneficial owner’s countries of residence and the level of risk for corruption and money laundering associated with these jurisdictions.
- Obtaining information regarding employment, including industry and sector and the level of risk for corruption associated with the industries and sectors.
- Checking references, as appropriate, to determine whether the account holder and beneficial owner is or has been a PEP.
- Identifying the accountholder’s and beneficial owner’s source of wealth and funds.
- Obtaining information on immediate family members or close associates either having transaction authority over the account or benefiting from transactions conducted through the account.
- Determining the purpose of the account and the expected volume and nature of account activity.
- Making a reasonable effort to review public sources of information. Those sources will vary depending upon each situation; however, banks should check the accountholder and any beneficial owners of legal entities against reasonably accessible public sources of information (e.g., government databases, major news publications, commercial databases and other databases available on the Internet, as appropriate).

Mazars USA can help financial institutions comply with BSA/AML requirements.

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**HEALTH CARE**

Physician Organizations: Managing the Risk Equation

By Stephen Wilson

Driven by an aging population, the development of new, high-priced pharmaceuticals, and the rapid expansion in coverage as a result of the Affordable Care Act (commonly referred to as “Obamacare”), more and more of the nation’s GDP is being consumed by the healthcare dollar. In response to these fiscally unsustainable trends, federal, state, and local entities, employer groups, and health plans and other third-party payors are mandating that the manner in which healthcare providers are reimbursed shall transition from a fee-for-service, or “pay as you go,” model to one founded on a risk-based, value-driven platform.

During this transition, it is worth looking at what is being pursued by California physician organizations, which have long been industry leaders in the development and implementation of various forms of risk-based healthcare delivery models. The risk, delegated model is well embedded throughout the state, which has led to higher quality, more efficient, more measurable, and less costly delivery of health care, resulting in improved patient experiences and outcomes. In the Commercial, Medicare Advantage, and Medi-Cal HMO space, the shared risk contracting model, wherein professional services are capitated to a physician organization and a shared risk pool is designed to incentivize alignment between the physician organization and health plan in the management of hospital and ancillary (“institutional”) services, has been a part of the contracting fabric for decades. There are many instances, both past and present, of the success of this type of contracting model. Unfortunately, there is now empirical evidence that, despite the best efforts of all stakeholders, institutional expenses incurred under the shared-risk model are increasingly exceeding budgeted dollars; in some cases, by double digit percentages.

The HMOs, many of which are for-profit entities, and thus accountable to their investors, are no longer willing to absorb losses year over year. Standard HMO financial pro forms are based on a targeted Medical Loss Ratio (MLR) being in the range of 83%-86% of the premium dollars, administrative and G&A expenses being in the range of 13%-15%, with profits margins in the 1.5%-3% range. When the MLR exceeds the top-end of the target range, it places pressure on the bottom line. In the shared risk model, given that the professional services are capitated, and thus can be budgeted for, it is the spiraling institutional expenses that are driving the losses. Although HMOs will continue to work with their physician organizations in an attempt to turn the tide of rising institutional expenses, their “turn-around” windows are becoming shorter and shorter before they decide to exit contracts, and eventually non-performing markets. For physician organizations, the impact of HMOs exiting their marketplace for Commercial, Medicare Advantage, and/or Medi-Cal products can be devastating. The membership related to these HMO arrangements can be in the tens of thousands, and even though best efforts are made to retain their membership through these transitions, disruptions are never a good thing. Members can choose to sign up with competing physician organizations, and then there is always the threat of Kaiser picking off its share of this affected membership.

In an effort to (i) keep HMOs from cancelling their contract or exiting their market, (ii) retain and expand their membership base, (iii) get closer to the top-line revenue source and thus better control the flow of funds, and (iv) exercise more control over the composition of the provider network, physician organizations are increasingly embracing the next evolution of the provider risk-based, value-driven platform, becoming Restricted Plans. Under this arrangement, the Restricted Plan becomes financially responsible for not only the professional services, but also the institutional services and, in rare instances, the costs of prescription drugs. Given that the Restricted Plan can now take risk for institutional expenses, it is now viewed as a “Plan.” The parties in this new “Plan-to-Plan” (Health Plan to Restricted Plan) arrangement negotiate a Division of Financial Responsibility (DOFR), which is a line item assignment of the professional, hospital, and ancillary services to be performed or provided. For undertaking the line items assigned to it, the Restricted Plan typically receives 83%-87% of the premium dollars, with the health plan receiving the balance of the funds to cover sales and marketing and those medical expenses for the services assigned to it in DOFR – services such as Out-of-Area, transplants, and prescription drugs.

Becoming a Restricted Plan does not come without its challenges. Firstly, the financial commitment can be very substantial, and far exceed the level of capital outlay that physician organizations are typically required to make as simply a risk-bearing organization (RBO). From an administrative perspective, the Plan’s organizational structure is not simply a “scaling-up” of its existing physician organization. Rather, it is a separate and distinct entity, with its own executive team, that oversees all of the delegated services and functions required under its Restricted Plan license. It must develop, and have approved, its own set of policies and procedures. In addition, a number of state and county DMCMP application process requires that the applicant complete numerous exhibits, with supporting documentation and various financial models, which describe in detail how it will develop, implement and execute on the clinical, operational, and financial functions for which it now is responsible. Given the breadth and depth of information submitted as part of the application, the review process on these applications typically run 6 – 9 months, but have taken longer on occasion. For Restricted Plans that later become interested in expanding outside their current service area, an abbreviated application process, known as a material modification, is submitted for each new service area and/or county.

Once a physician organization is armed with a Restricted Plan license, its ability to shoulder a bigger part of the risk equation makes it a very valuable commodity in the eyes of health plans. Not only is it assured of maintaining its existing contractual relationship with health plans, it is highly likely to gain even more market share (when health plans terminate under-performing, competing physician organizations and roll the membership into the Restricted Plan). From the health plan perspective, knowing it will be able to move into new markets with an existing, proven Restricted Plan partner will only enhance the relationship between the two entities, making the Restricted Plan an invaluable partner for the health plans in the long term.

As federal, state, and local entities, employer groups, and health plans and other third-party payors continue to mandate that the health care industry transition to risk-based, value-driven platforms for the delivery of health care, those physician organizations that have the vision, aptitude, and leadership to be on the cutting-edge of the next evolution of the risk equation, the Restricted Plan, will be well positioned for financial success and ensuring that their destiny is by choice, not by chance.

If not you, then who...your competitor? If not now, then when...when it is too late?

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D
uring 2017, the Consumer Products industry exploded with significant merger and acquisitions (M&A) totaling approximately $136 billion dollars for the first half of the year. In April 2017, 7-Eleven announced that they will acquire the convenience stores and gasoline stations of Sunoco. During June 2017, Amazon announced that they would acquire Whole Foods, and Walgreens announced that they will acquire approximately 2,200 Rite Aid stores. So why now? Why do these companies now feel compelled to acquire or merge? Traditionally, large consumer brands have spent billions of dollars on research and development to find efficient ways to mass produce. However, today large retailers are leaving innovation to the start-ups and replacing research and development with M&A activity.

“We can expect to see business models changing in the future as a result of M&A activity. With the “anytime, anywhere” mentality, brick and mortar locations will no longer be sufficient. Adding e-commerce and technology-driven platforms will be a must in order to stay competitive.”

The impact of the industry transformation on consumers can be both positive and negative. The merger of two large companies may result in price increases. As the number of actors in a market declines, it allows the remaining players to “price coordinate.” However, it may also work to the benefit of the consumer if synergies can result in cost savings that are passed along to the consumer. Customer service may also be impacted. The focus on e-commerce and click-to-connect technology removes the human element. Declining resources could result in overwhelmed customer service staff and dissatisfied customers. In order to promote customer service, pick-up, returns, and exchanges should be offered via any option, regardless of how an item was purchased. Boardroom conversations will shift to the identification of innovative investments and what makes an organization distinctive. They will analyze whether the best way to move forward is a cross-border transaction or perhaps it will be discussion about current consumer trends and behavior and how it is influencing the industry.

The overall mentality will emphasize consumer involvement, such as the use of crowdsourcing to develop and test new products. Finally, well-established companies will increasingly partner with early stage companies to create growth through new ideas.

Private equity firms are poised to invest, as the decrease in commodity and energy prices puts more disposable income in consumers’ pockets – making the consumer products sector attractive. With the need to repurpose businesses and consolidate cost structures, private equity firms will be in a position to provide both equity and guidance.

With continued competition for consumers’ discretionary spending retailers need to evolve and change. This requires adopting the “challenge everything” attitude. There is a new normal and the recent and continued M&A activity is the industry’s way of responding to changing consumer behavior.

If you are interested in gaining additional insight into M&A in the Consumer Products space, please join us on October 24, 2017 for Mazars USA Consumer Products Forum. We will be hosting a forum with some of the leaders in the retail and private equity industries, where they will be giving their insight as to the future trends in consumer products.

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SMES AND GLOBAL GROWTH: NAVIGATING THE LEGAL AND TAX MAZE

BY THE ECONOMIST INTELLIGENCE
SPONSORED BY MAZARS GROUP

Even within a free trade zone, exporting can be complicated by varying national regulations and tax regimes; outside of free trade zones, the complexities multiply.

A merican statesman and inventor Benjamin Franklin once famously said that nothing is certain in life except death and taxes. Nowadays, no one is more painfully aware of the certainty of taxes than small and medium-sized enterprises (SMEs) entering foreign markets for the first time.

The complexity of foreign tax, regulatory and legal regimes is the most frequently cited reason why SMEs avoid foreign markets. The range of such barriers is wide, encompassing different tax treatment for similar products in different countries, varying product composition and packaging rules, different standards for protecting intellectual property (IP), and complicated customs clearance procedures even within a free trade area. While the specific legal and tax barriers vary widely, they all represent essentially the same problem for SMEs: high compliance costs and the risk that, when implemented, regulations will be interpreted in unfavorable ways.

Such risks and costs are at the root of SMEs’ reluctance to export. According to the Confederation of British Industry (CBI), only one-fourth of European companies export. Dutch entrepreneurs’ association MKB-Nederland says that 20% of Dutch companies export; according to a survey by logistics giant UPS, only 10% of French companies export.

Complex tax and legal issues also explain why SMEs that do export tend to do so only within a free trade area. A large-scale survey of SME owners and directors in seven European countries, carried out by UPS in 2015, found that, in four of the seven countries looked at, the complications of clearing customs or of complying with export regulations was among the top three reasons for not exporting outside of the European Union.

Overall, around 80% of EU-based SME exporters confine their exporting to the EU, according to Ben Digby, the CBI’s international director. Others venture farther afield, but to markets with which the EU has a free trade agreement, such as South Korea. An example is offered by UK pottery and tableware manufacturer Portmeirion: It says its export business to South Korea skyrocketed after the country signed a free trade agreement with the EU in 2010. By 2011, South Korea had surpassed the company’s home market in the UK, and became its second-biggest market after the US.

Intricacies of VAT

Registering for reimbursement of value-added taxes (VAT) also presents a hurdle for many exporters, even within the EU single market. National VAT rates for the same product vary considerably across the EU: the standard rate varies widely, from 19% in Germany to 21% in the Netherlands and 24% in Greece. Moreover, some states impose ‘additional’ taxes on imported products, leading to variations in tax treatment even within the EU. Belgium taxes imported bottled water and fruit juices, for example, whereas neighboring France does not. All this causes headaches for importers, who must comply with a patchwork of European tax rules.

At company level, the VAT quill in Europe causes other types of problems. To receive reimbursement for VAT paid, a company must register with national authorities. The threshold for VAT registration varies widely among EU member states, from €10,000 in Portugal to €83,000 in the UK. One SME dealing with the VAT registration rules is Emojis Gourmands, a UK start-up selling French gourmet food in London. Emojis Gourmands founder and CEO Cecile Faure says that her firm buys directly from producers in France, does not use intermediaries and does not add a
big mark-up, thus enabling it to sell products at lower prices than UK supermarkets. But Ms. Faure says her firm’s small size puts it at a disadvantage in the VAT department. Her firm is not large enough to qualify for VAT registration in the UK. To avoid paying VAT on imports without being able to offset the tax payment through sales, Ms. Faure has to hire a freight forwarder to make the upfront payment. Details such as this can make even a deep free-trade area such as the EU less free than intended. “I applied for VAT registration several times but was repeatedly turned down,” says Ms. Faure. “It’s expensive for a small company.”

UNRAVELLING CUSTOMS CLASSIFICATIONS

A further complication for SMEs is finding a way through the thicket of regulations governing customs clearance and customs classification. An export product’s customs classification is more than just a number: it is a unique identifying code which determines the product’s tariff and VAT treatment, if applicable, and whether the product is permitted to be sold in the destination country in the first place. Some defense-related products, for example, are subject to both export and import restrictions. In theory, the World Trade Organization’s standard product classifications take all the mystery out of identifying products. In practice, it is not so simple, since the WTO’s guidelines can be applied inconsistently across countries. This causes problems for all types of companies, but SMEs, with their relatively limited resources, can be hit particularly hard.

Varying classification of the same product can appear even within a single market such as the EU, according to Christine Debats, international development manager at Conex, a small French company that handles customs clearance for importers and exporters. Television set-top boxes are classified according to their main function, for example. If this is deemed to be recording broadcasts, then imported boxes are subject to a tariff of 13.9%. If the main function is considered to be internet access, then the duty is 0%. The ambiguity comes when the box does both things—leading to a WTO ruling that the EU’s customs treatment of set-top boxes was out of compliance with its rules. That ruling, in turn, forced the EU to issue a complex set of new rules for classifying set-top boxes. This example shows how standardized customs classifications sometimes do not keep up with the rapid pace of product development, making it hard to predict the customs treatment of some goods.

But modernizing customs classification and clearing paper burdens of exporters and investors within the EU are causing a different set of problems. The EU’s planned Unified Patent Court, which is expected to start operating this year, will enable pan-European patent protection via a single filing, thereby cutting the cost of filing patents in multiple national jurisdictions. However, the unified system will also increase the risk of facing patent infringement challenges all across the EU rather than in individual countries.

That risk is increasingly a reality for exporters to and within the EU, as a result of the appearance in Europe of so-called “patent trolls.” These are firms that acquire patents to technologies that they have no intention of developing themselves, for the purpose of blocking others from using the technology. The patent trolls prevent the use of these technologies by threatening firms developing those technologies with patent infringement lawsuits.

The practice originated in the US, where patent trolling has become a big business. Specialist patent trolls are joined by multinational subsidiaries that actively buy and police patents in their sectors. A surge in patent litigation has led the federal government, as well as some US states, to clamp down on the trolls. One result of the US clamp-down “is that the patent trolls have come over to Europe,” says Edward Borovikov, a lawyer in France with global law firm Dentons.

So far, many of the problems have centered on Germany, where the courts support patentholders’ rights vigorously (as they do in the Netherlands), Mr Borovikov says. However, the pan-European patent system increases trolls’ potential rewards if they win a case, since compensation will be calculated across the entire EU and not only in the affected country. “A case will cost at least €200,000-300,000, which SMEs simply can’t afford,” says Mr Borovikov. “Twenty years ago, intellectual property was not a huge concern in Europe. Now companies must check very carefully for possible patent infringements to avoid being sued by trolls.”

Patent trolls are a particular threat to SMEs. In the US, half of all patent troll lawsuits are against companies with revenues of US$10m or less. The average cost of defending such lawsuits is US$2.3m—enough to put many SMEs out of business, according to Snapdragons, a consultancy offering intellectual property protections.

Similar cases are emerging against European SMEs. Toll Collect, a mid-sized German company with 600 employees, was targeted recently by such a case. It holds a government contract for a road-pricing system for trucks in Germany, with some terminals placed in neighboring countries including the Netherlands. Toll Collect was sued by a German firm, Papst, which owns a European patent for road-pricing systems. The case was filed in the Netherlands among other places, and a Dutch court found in Papst’s favor.

Staying clear of patent trolls is not, of course, the only issue for exporters wishing to protect their markets. In many parts of the world, the issue is far simpler: enforcing the IP protections already on the books. In China, for example, “the problem is not necessarily with the legislation, but with the implementation” of IP rights, says Christoph Kaiser, managing director in China for Turk Telekom, a family-owned German industrial automation company with annual sales of around €500m. Similarly, Dutch biotech firm Keygene has yet to set up a full subsidiary in China because of IP concerns.

Such concerns keep giant emerging markets such as China and India out of reach for many European SMEs. So, for instance, although most large Dutch companies such as Philips and ABN Amro are well established in both countries, few SMEs have followed their example. Fewer than 200 Dutch firms operate in India. A 2016 survey of Dutch companies active in China, carried out by the Dutch Ministry of Foreign Affairs, found only about 1,000 Dutch companies in the country, out of a total of 871,000 Dutch companies, most of them SMEs. “The barriers to doing business mentioned most often concern government relations and the Chinese regulatory environment,” the Ministry says. “Bureaucracy and the lack of transparency in legislation are the most common hurdles.”

Opaque rules and inconsistent application of regulations governing health products, among others, along with customs classification issues and variable VAT rates even within a single market create day-to-day problems for all exporters. These problems are felt most keenly by firms new to exporting and short on resources for figuring out the details of the regulatory, legal and tax systems in each of its export markets. Free trade agreements, along with various initiatives to reduce the paperwork burdens on exporters and cross-border investors, can help.

But occasionally, well-intentioned efforts, such as the pan-European patent filing system and the remote customs-clearance initiative, have unintended consequences that actually can increase the burden on exporters. It remains for policy makers to improve on these efforts, to avoid having newly internationalizing SMEs turn back from their efforts to venture abroad.

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2 http://www.snapdragon-ip.com/2016/01/20/patent-trolls-threaten-smes-innocence
3 http://www.epslawpatentblog.com/snap201107/ threatens-smes-innocence.html

FEATURED VIDEO

Women at Mazars - Be Visible featuring Lisa Minniti-Soska

Lisa is a partner in the Pennsylvania office and heads the Construction Group in the Real Estate Practice. Hear how her accomplishments as a female Partner allow her to lead others to success by scanning the barcode below!

To “Be Visible” means taking a proactive approach to demonstrating leadership while empowering others through shared knowledge. Our Be Visible campaign highlights women leaders who embody the core values and principles that the firm seeks to promote.
When I was 30 and a young auditor for the California Department of Health Services, one of the projects assigned to me was the audit of the Adult Day Health Care (ADHC) program. At the time, the ADHC program was new – operational for only a year or two, and in preparing for the engagement I wondered why the state was spending money on day care for older, sicker people? Because the focus of the audit was largely financial and a prelude to the state’s rate setting process, I did not dwell on the human side of the ADHC program or really think about all the services provided and how important they were to the safety and well-being of the daily recipients.

Today, I’m 40 years older and, as fate would have it, I’m once again involved in Adult Day Health Care. This time, however, I’m much more involved in how centers operate, their mission and vision, how they get paid, and in understanding the vital role a center plays each day in ensuring its recipients remain safe while the associated costs are mitigated as much as possible. As the population continues to age, it is critical for the well-being of the recipients involved, their families, the health plans that arrange and pay for ADHC services, and the economy as a whole, that Adult Day programs succeed in carrying out their mission.

For those who think ADHC is just day care...think again! Yes, it’s a place for family members to drop off their aging parents while they head off to work, run errands or simply use the time to get a little (and often much needed) respite from their 24/7 caregiving duties. But, ADHCs are so much more than a place to drop off Mom and Dad for part of a day. Consider for just a moment all the vital services that a typical ADHC provides on a typical day, and for those involved in managing full-risk Medi-Cal or Medicare Advantage contracts, note what unbelievable partners ADHCs can be when it comes to revenue enhancement and cost containment. Following are just a few of the most immediate benefits of partnering with ADHCs:

- ADHCs are physically in touch with your members several days a week. Where else within a typical managed care structure would it be possible to directly contact your high risk population this often? Nowhere else other than a nursing home, SNF, or acute care hospital setting.

- ADHCs provide food, shelter, safety, socialization, and a wide array of health care services in one central location. These services are essential to sustain life, preserve a person’s dignity and sense of well-being and it allows the highest risk patients to continue living in their homes or with help from family and friends, which is by far the least costly and most efficient way to preserve a high quality of living for elderly patients.

- ADHCs are more than day care centers, they’re actually Wellness Centers, which can attract interested plan members for all sorts of reasons. They can serve as a vehicle to complete Initial Health Assessments (IHAs), identify and report new Hierarchical Condition Category (HCC) information, feed updated information to case managers or the patient’s PCP. They can also assist members in locating a new PCP or reconnecting members to their existing PCPs, provide a host of wellness literature and communicate other information that health plans want to provide to their members on a regular basis.

- ADHCs provide dementia care, physical therapy, nutrition counseling, skilled nursing, medication reconciliation, home monitoring, transportation and other vital services that reduce the frequency of ER visits, and hospital admissions and re-admissions.

ADHCs can serve health plans and other risk bearing organizations (RBO’s) through the provision of high cost case management services, an area in which many health plans and RBOs are constantly short-handed and in need of help. ADHCs are ethnically diverse and their staff has the ability to relate to the range of cultures that exist within the populations they serve. Being able to understand and relate to patients is often half the battle in serving their needs and achieving compliance.

It is rare to find a health plan or risk bearing organization these days that is not committed to achieving the Triple Aim – improving the health of populations, improving the individual experience of healthcare and reducing its cost. With so much emphasis on keeping members healthy and out of the emergency room and hospital, I find it truly amazing that ADHCs are constantly struggling for market share, and have difficulty receiving compensation sufficient to cover their costs.

For those health plans and risk-bearing organizations who do understand the valuable services ADHCs provide, think again about the rates you’re paying, the absence of acuity adjustment and quality incentive sharing. Where else can you get the high touch services ADHCs provide for less than $100 per day? A single unnecessary test, referral or procedure will pay for a full day of adult day health care. One ER visit saved will often cover a month of ADHC services, and one hospital admission or re-admission saved will offset as much as a year’s service at most ADHCs. Talk about an ROI! There is nothing like it anywhere else in the health care system.

As I sat at the beginning of this story, regrettable, I was once counted amongst the group that thought ADHCs were unnecessary and a waste of money. But, after years in the trenches working with ADHCs and the California Association for Adult Day Services (CAADS) I have come to see ADHC in a much different light, and I’m convinced that my health plan and RBO colleagues will also come to realize that ADHCs are valuable resources and partners in the fight to achieve the Triple Aim.

If your organization is at-risk, consider adding one or more local ADHCs to your provider panel and solicit their involvement and expertise in the management of your high risk patients. They are incredibly savvy folks and likely know a lot about keeping high risk patients safe which can lead to significant cost savings for your organization if you work as a team!

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CRITICAL AREAS TO ACHIEVE SUCCESS IN TODAY’S MANUFACTURING CLIMATE

BY ALISHA JERNACK

In May 2017, the National Association of Manufacturers (“NAM”) held an executive forum on supply chain innovation in Houston, Texas. The event brought together company leaders to focus on emerging issues and trends, sharing on how to achieve success. Thought leaders, including Jay Timmons, CEO and President of NAM, Morgan Swink of Neeley School of Business, Ryan Lance of ConocoPhillips, Cindy Elliot from ESRI, Kelli Gregory of Dixie Chemical Company, and Gary Peterson of O.C. Tanner Company, shared their perspective on supply chain innovation.

Manufacturers today face many issues. There is uncertainty around taxes and regulatory matters. A shortage of talent and an aging workforce, make it difficult to find qualified workers to fill jobs. The United States is at a competitive disadvantage due to the high cost to manufacture domestically, and cybercrimes are at an all-time high in an era where new technologies are reinventing production.

The cost to do business in the United States is tremendous and many manufacturers, for years, have been investing elsewhere in the world. Today’s major cost drivers are taxes, regulations and infrastructure. The cost premium to manufacture in the United States is approximately 12-24%. Jay Timmons noted, “There are 297,696 regulations, which equates to $35,000 per year, per employee, in compliance cost for most manufacturers.” Other countries are lowering the cost of doing business by lowering their business tax rates. It is no wonder manufacturers are looking beyond the borders. To truly improve the economy, it will be just as important for the administration to bring down tax rates for pass-through entities and individuals as it will be to bring down corporate rates.

There is a lot of opportunity for change and growth in the overall economy. Ryan Lance says “there is the opportunity for 2-3% growth in the U.S.” Jay Timmons shared that “NAM’s first quarter 2017 economic survey was presented to the President and a group of manufacturers – results showed the highest confidence in economic outlook in 20 years at 93% confidence level.” Perhaps this is the generation with the opportunity to improve the business climate in the United States.

Another prevalent issue putting American manufacturers at a disadvantage is the shortage of qualified workers. Jay Timmons stated “3.5 million jobs in manufacturing will be created over the next decade because of new jobs and aging workforce. 2 million of those jobs will go unfilled if nothing changes, because we don’t have the right skills.” Another challenge is putting the right people in the right jobs. It has never been more vital to attract and retain quality people that fit your particular corporate model and to provide them with the tools and information to succeed.

Supply chains are no longer linear – they have transformed into networked organizations. Cindy Elliot shared her insight that “Today is a society where the majority of the population has more than we need. It is the age of abundance. As population and consumer buying potential continue to grow, the need to ship globally will continue to grow and pressures to the supply chain will continue to manifest.” We need to have information at our fingertips, in real time in the revolution of speed and change.

Businesses should be thinking about how they can proactively work around delays, understand upcoming issues, and come up with alternatives. It is becoming more and more popular for manufacturers to focus on outcome based, or performance based services. They need to be able to anticipate shifting customer needs and respond to them. They also need to understand where customers are going. This is a very different model from a traditional manufacturer focused on output. Manufacturers are now offering wrap-around services or partnering up with service organizations. They are diversifying to evolve with the industry and becoming a provider of services.

In a recent survey of 120 mostly small and mid-sized NAM members, it was found that 78% of businesses focus on direct costs and only 17% on indirect costs. Indirect costs are often those that no one wants to be accountable for. They are a much smaller focus. Kelli Gregory stated that indirect costs “can be the big game changers in the end. Hidden costs that people aren’t really going to notice that can make a big difference.” Centers of excellence can begin with indirect costs, as there are a lot more opportunities for synergies. In the recent NAM survey, nearly 50% of respondents struggled with developing a supply chain strategy and implementing those tactics. Key takeaways from the survey showed that businesses should focus on pragmatic actions. Things that are less complex in nature can sometimes yield the highest return and greatest results. A second takeaway was to build
Manufacturing

Manufacturers need to strategically manage and adopt change. Morgan Swink defined innovation as “the intention to strategically manage change.” This can be extremely difficult when stuck in day to day operational activities. Having an end to work towards can make change more attainable. In order to optimize and streamline the supply chain, it's necessary to understand and identify how individual organizations add value beyond cost reduction. It is also critical to know an organization’s differentiator. There needs to be strategic initiatives to re-imagine core business models. Intelligence in supply chain should include visibility, analytics and flexibility.

Results from the recent NAM survey also showed that centralizing procurement and building closer relationships have a high impact and are frequently employed. The highest returns come from developing partnerships and identifying how individual organizations add value beyond cost reduction.

Strategic initiatives to re-imagine core business models. Intelligence in supply chain should include visibility, analytics and flexibility. Businesses need to get involved in the front end of their supply chains. This goes for internal operations as well. There is value in building teams that drive continuous improvement bringing processes closer together can pay large dividends.

Collaboration and leadership are at the heart of innovation. Kelli Gregory thinks that “If you don't have good leadership that leads innovation, then it doesn’t matter what stage your company is in, you're not going to have good innovation.” It is now more common to hire to culture and aptitude rather than experience or skills, which can be learned if the right leadership is in place. Collaboration is imperative. Gary Peterson said “people trust leaders and leaders trust people.”

It is ever so important for manufacturers and business owners to focus on emerging issues to achieve success. Businesses should be able to anticipate shifting needs of customers, remain at the forefront of technology and treat their people and supply chains as their greatest assets. So what are you doing to turn today’s issues into opportunities?

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Transportation & Logistics

E
ey and equity based incentive compensation plans can be instrumental tools for a logistics company to becoming a high performing business and retain key employees. The types of incentive compensation plans vary and each can be customized to meet the goals and objectives of the employer. Growing a company’s business can begin with the simple step of selecting the most effective incentive plan for a company’s growth strategy and working with a financial benefits consultant to design the logistics to perfect the implementation and timeline accurately.

One of the most important features to retain key employees and to promote growth is utilization of a carefully designed financial strategy tied to a vesting schedule in the plan that is beyond time based and rather focuses on company performance.

Business owners should not consider these to be giveaways to employees, but rather use this technique as a tool to drive high performance which in turn leads to increased productivity. To successfully implement this strategy, it’s important to set goals through qualitative data that directly relates to increased profitability and cash flow. Some examples of commonly measured KPIs for logistics companies focus on setting clear and measurable goals with lead times, pick rates, on time in full deliveries, turn times, and customer claims. The list goes on, so it’s important to identify meaningful and impactful goals and tie them together so your team can see the incremental impact it can have on performance, and ultimately turn into incentive compensation. These KPIs, as well as many others, are a measurement of productivity that will lead the company to greater gross profits.

The following is an overview of the features of the most typical plans used to motivate employees to achieve stunning financial success for a company and help you to reach your revenue or productivity goals.

Non-Qualified Stock Options (NQSO) provide employees with the right to purchase a stated number of shares, with the price fixed at grant for a specific number of years. A plan is designed and drafted to meet the employer’s considerations for incentivizing and retaining the employees and allowing them to share in the company’s success as an equity owner. There is no taxation.
Incentive Stock Options (ISO) allow the employee to defer the taxation upon exercise of the option until the date the underlying shares are sold. At disposition, when the shares are sold, the amount from the price at grant to the price upon sale is taxable at capital gains rates rather than at ordinary income tax rates. In order to take advantage of this special tax treatment, the employee must be granted options from an ISO plan that complies with tax law requirements and hold the stock at least one year from the date of exercise and two years from the date the option was exercised.

Restricted Stock (RS) provides employees with the right to purchase shares at the fair market value, or may be provided to employees and subject to defined restrictions. A company can design specific corporate and individual performance goals that can be provided to trigger lapse of the restrictions. With RS, a company can decide whether or not to allow dividends to the grantees of the award. If an employee receives a grant of an RS, then within 30 days they may make an election under Section 83(b). If the election is made, the employee will be taxed currently on the value of the RS, but will receive capital gains treatment upon the later sale of the asset when the restrictions lapse. This is an attractive feature if the value of the RS is low at the time of grant. If the election is not made, then the full value of the RS, less any amount paid for the shares at grant, is taxed at ordinary income tax rates upon the lapse of the restrictions.

Restricted Share Units (RSU), although the name alludes to the grant of equity, do not actually grant employees shares. This incentive vehicle can be designed to be settled in shares or cash upon the lapse of the restrictions. The employee is taxed on the amount of the appreciation in the RSU from date of grant to date of vesting at ordinary income tax rates. If vesting is contingent on the employee achieving individual or corporate performance goals, that will help the company manage financial commitments in settling the award.

Share Appreciation Rights (SAR) and Phantom Shares are similar, as both provide a right to receive the increase in the value of a designated number of shares or other benchmark, which can be settled and paid in cash or stock. SARs and Phantom Shares are a form of deferred compensation that can be targeted to specific company goals. In a carefully designed incentive plan, without improvement in the company’s bottom line, there will likewise be no appreciation of the SARs or Phantom Shares.

Deferred Compensation and Incentive Bonus can both be designed with payment contingent on attaining performance criteria with minimal cost, if tied to company achieving desired financial results.

Key to Becoming a High Performing Company

To reach a company’s financial goals, it is useful to consider that one of the most valuable assets in attaining stunning corporate results is your human capital. Knowing how to tap that resource to be in sync with the company’s financial objectives and timeline can be daunting unless the correct incentive plans are in place. If a company has not implemented an incentive plan, or has a plan but it isn’t achieving the desired outcome, it may be time to revisit plan type and design. Putting in place a program that ensures all of the company’s assets are working in sync with high performing logistics to take a company on the road to success could be the most important next step.

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Another Annual Inspection Report
It’s late summer, which means the PCAOB Annual Report on the Interim Inspection Program Related to Audits of Brokers and Dealers (“Sixth”) results are in. The Sixth brought more information for consideration, but no clarity on the PCAOB’s direction in proposing the final inspection program. A permanent inspection program was expected as last year’s annual report noted that the PCAOB would in late 2016; issue a proposal for the final inspection program. The process could be lengthy as SEC approval is also required.

The Sixth was issued on August 18, 2017 and brought many of the same comments, and high deficiency rates of the preceding five inspection reports.

The PCAOB provides auditors substantial feedback on their performance through their Annual Interim Inspection Reports (2012-2017), Staff Inspection Briefs, various industry forums, staff guidance and other communications. Areas of improvement continue to be outlined. This feedback enables auditors to improve and design audits to meet auditing requirements under PCAOB standards (in effect since June 2014). The consequences, to the broker-dealer can be dire and costly if an audit is not performed in accordance with PCAOB standards. The PCAOB has in various forums, webinars, publications and meetings with the Stock Brokerage Committee of the New York State Society of Certified Public Accountants stated that deficient audits can and have caused a re-performance, a recall of reports and potentially referrals to regulators, namely the SEC and FINRA. The Sixth notes where various censures and referrals have occurred.

Annual Inspection Report Selection
For the year ended June 30, 2016, the population consisted of 531 audit firms who audited 3,833 broker dealers. (down from 2012 when approximately 800 firms audited approximately 4,402 broker-dealers). The sample size for the Sixth inspection was 75 firms and 115 audits, which was identical to the prior year’s selection.

The PCAOB selected 11 firms to review randomly and another 64 based on firm characteristics defined in the report, including:
• the number of broker dealer audits performed
• whether the firm audits issuers
• previous history of inspections
• history of the firm or firm personnel in auditing broker-dealers
• existence of disciplinary actions against the firm or engagement partner

It is interesting to note that the PCAOB’s selection process has resulted in 334 inspections of 264 firms, and 514 audits, (some of which have been inspected multiple times). Approximately 50% of auditors who audit broker dealers have been inspected since the program started. However, approximately a third of those accounting firms that audit only one broker dealer has been inspected (approximately 150).

Findings
83% of the inspections noted a deficiency, up from 77% from the prior year’s inspection. Additionally the percentage of those audits that were inspected, which had independence issues was 10%, up from 7% from the previous year.

The engagements inspected had the following rates of deficiency
• Independence (10%)
• Revenue (86%)
• Risks of material misstatements due to fraud (57%)
• Engagement quality review (57%)

Other deficiencies included net capital, fair value measurement, exemption and compliance reports, and related parties.

Independence
The PCAOB and SEC continue to bring independence sanctions against auditors of broker dealers. SEC Rule 17a-5 requires that an auditor must be independent in accordance with Rule 2-01 of SEC Regulation S-X. Currently, certain carve outs exist under PCAOB standards for non-insurer broker-dealers. The carve outs include partner rotation and the ability to perform tax compliance services for those in financial reporting roles.

Considerations where a mutual or conflicting interest may exist, or where the accountant is placed in the position of auditing his own work, or acts in a management capacity, or an accountant advocates for the client are all prohibited pursuant to SEC Rule 2-01.

The Sixth inspection revealed, as in prior inspections, instances where the auditor prepared or assisted in the preparation of the financial statements. This shows an apparent disregard for, or lack of awareness of, this prohibition under the independence rules. While editorial suggestions and educational materials can be supplied to the client, it is important to realize that the auditor is not the decision maker in the financial reporting process. Additionally, in one instance an engagement letter included an indemnification clause, which is also prohibited.

Revenue
The PCAOB states that one continuing issue has been that when testing revenue the extent of testing was not sufficient (43 instances). Examples include the auditor did not:
• Test the material classes of revenue
• Sufficiently test controls when the auditor placed reliance on their controls to reduce substantive testing
• Appropriately design and perform sampling procedures to test revenue transactions.

These comments should cause the auditor to ask whether adequate testing of income streams have been considered, as aggregated income line items may have different characteristics. Are controls designed to enable the auditor to reduce substantive testing? When using sampling the auditor needs to ensure that all items in the population have a chance of being selected, and that specific time periods or amounts do not limit sampling.

The PCAOB also found 25 instances where the auditor did not properly evaluate the service auditor’s report (‘SOC-1’ report). When an auditor relies on controls at the clearing organization with the purpose of limiting substantive testing, the auditor needs to consider several procedures. First, the auditor must consider testing the operating effectiveness of the user controls as noted in the SOC-1 report. If a sub service provider is mentioned in that report, the auditor must also consider that sub service provider’s user controls. The PCAOB also noted that where the period included in the service organization report does not coincide with the audit period, the auditor would have to perform substantive work for that uncovered period. The effect of the above could conceivably make the auditor come to the conclusion that substantive procedures and, therefore, increased testing; is the practical approach, and not rely on a service provider’s SOC-1 reports.

Additionally, The PCAOB staff noted numerous instances where the auditor did not sufficiently test the accuracy and completeness of information produced by the broker dealer, noting lack of adequate considerations on reports, trade blotters, tickets, schedules and spreadsheets. This information needs to be tested in order to satisfy assertions of accuracy and completeness.

Another important note is that auditors need to perform sufficient procedures whenever contractual arrangements exist such as in underwriting agreements, clearing agreements, commission pay outs, and expense sharing agreements.

Fair Value Measurement
The deficiencies in this area included:
• The auditor failed to understand the broker dealer’s process for fair value measurement, including the description of the methodology. The auditor needs to consider the inputs used in the valuation.
• The testing of fair value was not adequate. In some instances the auditor tested fair value by using the clearing broker’s confirmation, and did not consider any additional procedures.
• The testing of management’s process was not sufficient.
• The pricing used by the auditor was not independent from the external pricing service used by management.
• The recorded amounts were simply an amount noted by the clearing broker and accepted by the auditor without further audit work performed.

Risks of Material Misstatements
The PCAOB notes “when identifying and assessing the risks of material misstatement due to fraud, the auditor should presume that there is a fraud risk.” The presumption is that revenue recognition is always a fraud risk. If this is not the case, the auditor needs to document the reasons supporting the conclusion that revenue recognition is not a fraud risk. Additionally, the auditor needs to identify fraud risk and address management override of controls. Journal entry testing should be designed to identify controls in place and needs to include not only a sample during the year, but at the end of the reporting period.

The auditor must also perform inquiries of management and document such procedures.

Engagement Quality Review (“EQR”)
The PCAOB noted in their Sixth report that 57% of inspections, a deficiency existed in the area of EQR review.

The engagement quality review process is, in many cases, the last control an accounting firm utilizes to ensure a quality audit. For eight of the engagements selected, an EQR was not performed, which is an obvious control the accounting firm utilizes to ensure a quality audit. For eight of the engagements selected, an EQR was not performed, which is an obvious control an accounting firm utilizes to ensure a quality audit.

The PCAOB noted in their Sixth report that in 57% of inspections, a Quality Review (“EQR”) was not performed. Additionally, the auditor needs to document the reasons supporting the conclusion that revenue recognition is not a fraud risk. If this is not the case, the auditor needs to document the reasons supporting the conclusion that revenue recognition is not a fraud risk. Additionally, the auditor needs to identify fraud risk and address management override of controls. Journal entry testing should be designed to identify controls in place and needs to include not only a sample during the year, but at the end of the reporting period. The auditor must also perform inquiries of management and document such procedures.

The EQR review should include:
• Reviewing the report and work papers that are essential in developing an opinion
• Evaluating the audit response to identified risks
• Reviewing for compliance for independence
• Reviewing the engagement completion document.

The pertinent areas of the EQR are seemingly accomplished with the diligent completion of an EQR checklist, and substantiating that those steps were indeed performed. It is essential that the person performing the EQR has the expertise and knowledge to perform his/her responsibilities in accordance with the standards, and that the individual be of partner status or a person in an equivalent position. The EQR is put in the position of challenging the engagement team and must not only have the requisite experience, but be able to withstand pressure from the engagement team.

The Audit Landscape
Auditor selection should be a serious exercise for the broker dealer. Judging from the statistics released in the Sixth, which reaffirmed inspections one to five, many audit firms may be viewing the risk of auditing a broker dealer to be too high, as standards require a broker dealer to be audited similarly to an issuer.

The expertise required could also be diminishing the market. There are a large number of auditors who audit only one broker dealer, and many that audit less than twenty. The expertise may be very difficult to obtain, if a firm is not auditing a significant number of broker dealers. The PCAOB also noted the correlation between those firms that audit more broker dealers, and auditors who have a lesser deficiency rate in the audits inspected. Further contraction of the auditor market may result.

The Future
The PCAOB staff is expected to recommend to the Board a permanent inspection plan presumably in late 2017 or early 2018, although it is important to note that this was expected at the end of 2016. The Board will review the Plan and potentially put it out for comment to the industry. After the comment period, the Board may pass the proposal along to the SEC or re-propose. The SEC would then review and also put it out for comment to the industry. The process could take a bit of time. It’s important for auditors, and broker dealers to give input to the Board’s and SEC’s proposals as the permanent inspection program could have a sizable effect on the industry in terms of cost, frequency of inspection, potential carve outs, and ultimately audit quality.

The PCAOB has scheduled two Forums for Auditors of Broker-Dealers in the next three months, one in Las Vegas on October 20, and another on December 7, in Jersey City. The forums bring additional insight on the PCAOB’s thought process, and enable attendees to address their concerns.

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New York State Adopts Detrimental Receipts Factor Methodology
By Harold Hecht and Seth Rabe

In guidance memorandum NYT-G-17(2), C, issued by New York State on August 2, 2017, impacting tax years prior to 2015, the Department of Taxation & Finance denies customer-based apportionment of receipts for a corporate entity that holds an interest in a single member LLC that is a registered broker-dealer in securities. Corporations pay tax to New York by apportioning federal taxable income, subject to certain state modifications, by the percentage of receipts earned in New York to the total receipts reported for federal purposes. All issues in the specific treatment provided in the tax law of receipts that arise from various transactions involving registered securities brokers-dealers. In a concession to the financial services industry, New York State had provided for tax years prior to 2015 that such receipts could be apportioned to New York based upon customer location rather than where the services were rendered. This legislation was highly beneficial to New York based broker dealers, which were allowed to report a lower tax base to the state when a large portion of their customers resided outside New York.

The guidance addresses a taxpayer that is an investment advisor not registered as a broker dealer. The advisor owns a single member LLC that is a registered broker-dealer for income tax purposes, New York, similar to the federal tax treatment, disregards a single member LLC and treats it as a division of the owner. Despite the disregard-ed entity treatment, the state advises that a single member LLC’s status as a registered broker-dealer with the SEC cannot serve to qualify the parent investment adviser as a registered securities broker-dealer. Accordingly, the state has informed taxpayers that it will only extend the customer-based apportionment of receipts to services specifically performed by the single member LLC.

This controversial new policy is similar to one previously issued by New York City that was widely criticized by tax professionals as being selective in its application of the flow-through attributes of disregarded entities. For impacted taxpayers, this new policy may result in substantially higher New York State and City tax liabilities. This new policy does not impact tax years beginning on or after January 1, 2015, as New York State extended the customer-based apportionment of receipts to all Article 9-A (C-Corporation and S-Corporation) taxpayers.

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THE IMPACT OF THIS ADMINISTRATION’S PLANNED REDUCTION TO CORPORATE INCOME

BY YENSY SANTIAGO

Introduction

The US corporate tax system has remained largely unchanged since 1986. However, on April 26, 2017, the Trump administration publicly released its plan to significantly reduce corporate income tax rates by passing legislation for comprehensive tax reform. The proposed tax reform calls for a reduction in corporate income tax rate from the current 35% to as low as 15%.

Tax Reform

Trump administration officials and congressional Republican leaders are in the process of negotiating the terms of a tax reform bill (the “Trump Plan”). However, to date, neither legislation nor detailed plans have been introduced, only a high-level tax reform proposal.

The proposed objective of the Trump Plan is to provide tax reform and simplification by imposing a lower corporate income tax rate. The Trump Plan proposes switching to a territorial international tax system for U.S. companies’ foreign earnings, in order to level the playing field for American companies and bring trillions of dollars from offshore to be invested in the U.S. Furthermore, Trump’s Plan also proposes a one-time tax on the repatriation of foreign earnings of U.S. companies at an unspecified rate and to eliminate tax breaks for special interests.

President Trump has called for a proposed corporate income tax rate of 15%, while the House Republicans have set a goal of 20%. A specific target rate has not yet been set, however we understand that some credit rating agencies have begun to include a 25% corporate tax rate assumption in their modeling in anticipation of the Trump Plan.

If enacted, the legislation could have significant income tax accounting implications for companies in the U.S., especially in the year the change is enacted. Companies should continue to monitor developments in this area and evaluate the potential future accounting effects, as it will require careful consideration and preparation. Additionally, depending on the timing of when the reform bill is signed by the President, companies may have limited time between the date of enactment and the end of their financial reporting period. Although the Trump administration has commented that it expects the bill to pass before 2017 year end, many consider this to be an agresssive timeline, with 2018 being more realistic.

A reduction in the corporate income tax rate could significantly impact regulated utility companies and their customers. Unlike other commercial enterprises, regulated utilities deal with the complexity of economic regulation and the ratemaking process.

Accounting Implications and Considerations

Under U.S. Generally Accepted Accounting Principles (“GAAP”), Accounting Standards Codification 740 (ASC 740), “Income Taxes,” a change in enacted tax law and/or tax rates is recognized in the period in which the new legislation is enacted. A reduction in the corporate income tax rate will affect current tax expense, current tax payable, as well as deferred tax expense and accumulated deferred income taxes (“ADIT”). The total effect of income tax law changes on deferred tax balances is recorded as a component to tax expense related to continuing operations for the period in which the law is enacted, even if the assets and liabilities relate to discontinued operations, a prior business combination or items of accumulated other comprehensive income.

Regulated utility companies operate as a monopoly, and as a result are regulated by either a state public utility commission or the Federal Energy Regulatory Commission (“FERC”). The regulators are tasked with ensuring the tariffs charged to the customer are fair. To accomplish this, the regulator requests rate case filings from utilities to present information about operating and capital costs incurred for a period of time. Regulators use the information to determine the proper rate a regulated utility company can charge its customers in recovery of operating costs plus a reasonable return on capital. The

Rate base primarily reflects the utilities’ investment in property, plant, and equipment (“PP&E”). When determining the rate base, utilities subtract from the value of their PP&E the value of deferred tax liabilities that arise from the differences in reporting depreciation for rate-setting purposes versus depreciation for tax purposes. A reduction in the corporate tax rate would reduce the disposition value of these liabilities by diminishing actual future tax liabilities. Also, the excess tax liabilities would be returned to ratepayers through lower rates.

However, utilities have taken advantage of accelerated depreciation for tax purposes as a means of financing capital expenditures. By reducing interest free ADIT, utilities will need to find new sources of capital, such as debt and equity, to fund their capital expenditure needs. Regardless of whether it is replaced by debt or equity, it will come at a higher cost, which will ultimately drive higher tariffs.

Conclusion

We do not currently know how tax reform will play out, however the current administration will certainly push forward on this initiative in the near term. It is smart for companies to consider how potential changes could impact their operations, budgeting, financing, and reporting so that they are prepared.

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WHAT IS A SYSTEMICALLY IMPORTANT FINANCIAL INSTITUTION?

BY SAMUEL PIZZICHILLO

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") was written in response to the repercussions of the 2008 financial crisis—and to prevent (or lessen the impact) of the next one. A key part of the Dodd-Frank Act was establishing the Financial Stability Oversight Council ("FSOC"). In this article, we discuss some of the expected changes under the new administration.

A Systematic Approach to Financial Stability

Title I (Subtitle A, Section 111) of the Dodd-Frank Act established the FSOC, comprising 10 voting members: the senior officials at each of the nine federal financial regulators and an independent member with insurance expertise who is appointed by the President and confirmed by the Senate for a six-year term. The FSOC also has five nonvoting advisory members: three from various state financial regulators and the Directors of the new Federal Insurance Office and Office of Financial Research.

According to the U.S. Department of the Treasury, the FSOC was established to bring together federal and state financial regulators to look across the financial system to identify risks to financial stability, promote market discipline, and respond to emerging threats to the stability of the US financial system. One of the FSOC’s statutory purposes is to identify those risks that could arise from the material financial distress or failure, or ongoing activities, of nonbank financial companies.

Designation of Systemically Important Financial Institutions ("SIFI")

Under Section 113 of the Dodd-Frank Act, if the FSOC determines that the material financial distress of a US nonbank financial company, or the nature, scope, size, scale, concentration, interconnectedness, or the mix of activities of the US nonbank financial company, could pose a threat to the financial stability of the United States, the FSOC has the authority to subject that company to consolidated supervision by the Federal Reserve and to enhanced prudential standards.

Section 165 of the Dodd-Frank Act set a statutory asset threshold for automatic designation of nonbank financial companies and bank holding companies as systemically important. This asset threshold is currently set at a static $50 billion. Former US Congressman and co-author of the Dodd-Frank Act, Barney Frank, has stated on numerous occasions that the $50 billion threshold was an arbitrary number that was determined during the legislative process. After Dodd-Frank had passed, he (and many others) believed that the $50 billion threshold was too low. In addition, Mr. Frank contended that the threshold should have been indexed to inflation—so that it would remain a static figure. In interviews and various events, he has suggested a better threshold might be a $125 Billion benchmark.

Recent Developments

In April 2017, President Trump issued a memorandum for the Secretary of the Treasury regarding the FSOC. In the memorandum, Trump directed the Secretary to conduct a thorough review of the FSOC’s processes, potential improvements, and recommendations for any legislative changes necessary to improve their processes.

In June 2017, the U.S. Department of Treasury released a summary of its recommendations for regulatory reform. With regard to the SIFI asset threshold, the report stated "Treasury recommends that Congress amend the $50 billion threshold under Section 165 of Dodd-Frank for the application of enhanced prudential standards to more appropriately tailor these standards to the risk profile of bank holding companies." Although this report did not specify a new asset threshold, it telegraphed that the Treasury agreed with the commentary that many other Republicans and Democrats had expressed regarding this particular requirement of the Dodd-Frank Act. For example, Senate Banking Committee Chairman, Mike Crapo, has also stated that he intends to review the current $50 billion statutory asset threshold, codified in Section 165 of the Dodd-Frank Act, for automatic designation of systemically important financial institutions. Crapo pledged to work with the House Financial Services Committee to "craft a more appropriate standard" for SIFI designations.

On July 27, 2017, Secretary of the Treasury, Steven Mnuchin, provided testimony to the Committee on Financial Services on "The State of the International Financial System." In response to a question from Congressman Jeb Hensarling regarding what the asset threshold should be, Mr. Mnuchin stated, "I think that it should be raised substantially, at least to $250 billion or $300 billion." Additionally, Mr. Mnuchin noted that regulators should also have flexibility to look at qualitative factors in determining whether the SIFI designation is appropriate (i.e., in cases where there are "simple" financial institutions that happen to exceed the asset threshold). Based on the above developments, and bipartisan support for the changes to the Dodd-Frank Act, we believe that a change to the SIFI asset threshold as prescribed by Section 165 should be passed relatively quickly through the legislative process. Stay tuned for future updates on the status of the Dodd-Frank Act, any changes or amendments made, and the potential effect it will have on financial institutions.

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The Evolution of Claims Processing

By Brett Johnson and Agnes Lau-Fernau

Technology is evolving daily, and consumers want product and service information in real-time, not weeks, days, or even hours. Many operational leaders are laden with disparate data, limited tools, and budgets to invest. In addition, the number of potential solutions in the market is vast and confusing, leaving consumers in a quandary on where to start. Industries are transforming more quickly than ever, and any delays in the flow of information can greatly hinder an organization from reaching their operational goals and limit their ability to serve their clients. Organizations need to innovate and break away from the simple trends to be successful, following industry trends is not enough. While the insurance industry may not be ready for droids from Star Wars, progressive companies are finding that advanced technologies, like Robotics, is helping them innovate and improve productivity.

Claims Processing in the insurance industry is an area that is ripe for innovation and evolutionary change in the way things are done. In spite of the world’s ability to leverage advanced technologies, Claims Processing is still a highly manual process that requires hours of human effort and is susceptible to errors. However, companies are smartly applying technology to improve existing administrative processes. Leading organizations recognize that the process of adjudicating a claim is like many repetitive, factory transactions that have long been automated through technology. The partnership of technology and Claims Processing promotes both potential operational and cost efficiencies.

The most recent technological advances in Claims Processing have been revolving around Robotics. Robotics or Robotics Process Automation (“RPA”) is the automation of a process that contains a set of repeatable, routine tasks. These processes are often comprised of time-consuming, data entry oriented tasks; by implementing RPA, Organizations can reduce risk and deliver faster, more accurate results. While these efficiencies are intriguing to many leaders, what does RPA mean in an office environment? As a very basic example, developing and using a Microsoft Excel macro is a type of RPA. A macro is an automated input sequence that imitates keystrokes or mouse actions, just like when a robot performs actions that previously were completed by human workers. In the following paragraphs, we will discuss the advantages and operational efficiencies that the use of Robotics can generate for an Insurance Organization’s Claims Processing function.

One of the most common challenges that insurance companies contend with is the processing of claims involving single claims or small batches. Most organizations store their data in multiple locations, different systems, and potentially even in different formats. Additionally, many organizations use different vendors for their Claims and Policy Administration solutions which compound the risk of communication barriers and in turn cause the process of claims processing to be somewhat inefficient. Automated functions such as Robotics, bridge the gap between disparate solutions and pull data into a central, standardized location. Designing effective Robotics solutions and processes provides Insurance leaders with ways to develop automated workflows that pull data on a scheduled basis so that recent data is always available and easily accessible.

In today’s world, Claims Processing is still a very manual process. Full-time resources are pulling information from a source file (either paper or electronic) and keying the data into the appropriate system(s). By and large, manual processes that can lead to key-in data errors (Human Error) resulting in inaccurate claim information, which in turn can lead to lengthy delays in processing and claim payouts. Organizations have embraced the use of RPA to automate existing claims processes have been able to redirect the human effort in their claims processing departments or eliminate the majority of the human effort involved, drastically reducing the risk of human error. In addition to the reduced human error, the act of keying claims detail into a solution is a time-consuming process. RPA allows organizations to shift the focus of their trained resources away from monotonous data entry to value-added tasks of claims review and analysis.

• Productivity Benefits Greater Than 60%,
• Standardized Processes,
• Research and experience illustrate that companies using RPA have generated impactful and lasting results including:
  • Transaction Processing Improvements by up to 50%,
  • Standardized Processes,
• Reduction of Manual Effort by Nearly 90%, and
• Fostering an Environment that Supports Risk-Free Processing of Sensitive Data

Strategic introduction and blending of modern technology to assist a standard process, such as Claims Processing, represents an innovative way for Insurance leaders to drive evolution and generate a substantive return on investment. Let Mazars help you identify areas of improvement with technology.

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WHERE ARE THE WOMEN IN CONSTRUCTION?

BY LISA MINNITI-SOSKA

Recently, while out to dinner with friends, I mentioned that I was involved in an initiative with the goal of enhancing the development and retention of women accounting leaders in our firm. I asked one of my friends, a glazier, how many women he works with. He responded that there were none. I turned to my husband, who also works in the construction industry, and asked him how many women he works with in the field. He, too, responded none.

According to the Department of Labor's (DOL) Bureau of Labor Statistics, women represent 46.8 percent of the workforce. So where are all the women in construction and how does the lack of women affect the future of the industry? The same DOL statistics show that a mere 9.1 percent of women in the workforce participated in construction in 2016 and the majority of these women worked in administrative roles. While the number of women involved in other industries continues to increase, the same growth is not seen in construction.

Hurdles from Childhood

There are a number of barriers to women interested in entering the field. Starting from an early age, girls learn to perceive construction as a male-only career choice. Young girls typically see their fathers, uncles, brothers or other men participate as construction workers, causing them to assume there is no place from them. However, the increasing number of women in other male-dominated careers, such as firefighters and police officers, tells us that this is not the only obstacle that needs to be addressed. Those that are interested in entering the industry can often become deterred by the unfortunate shortage of female role models. Even the women who have navigated through previous obstacles often abandon their course because of gender bias and fear of being shamed or discriminated against by colleagues or others in the field.

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Particularly in fields requiring physical work, gender bias can create a workplace culture that is dismissive of women's abilities, making it difficult for them to break into the field. Women who do manage to get hired for construction jobs are often the subject of gender stereotypes, resulting in employers making assumptions about their caregiving responsibilities or physical capabilities.

Unfortunately, gender quotas are falling short of solving the problem. Sometimes women are put to work on a job solely to show a company is meeting gender goals. However, once the project is completed, women are often fired regardless of their performance or skills. Research shows that women in construction are less likely to have access to mentors who act as career promoters by signaling the woman's potential and providing the support needed to ensure success.

Why Do We Need Women in Construction?

Ignoring the lack of women in construction is shortsighted. The construction industry is experiencing a fundamental shift, as a looming labor shortage is creating fierce competition for workers. Economists are also predicting significant growth in construction spending, causing construction companies to face problems with the lack of available resources. In addition, technology is transforming the way projects are designed and diversity is increasingly becoming an important focus within the industry, in an attempt to bring in new points of view and ways of problem solving by expanding the range of workers' backgrounds and experiences. As a result of these changing trends and baby boomer retirement, the construction industry needs to rethink its strategies to attract, recruit and retain female workers.

“SOMETIMES WOMEN ARE PUT TO WORK ON A JOB SOLELY TO SHOW A COMPANY IS MEETING GENDER GOALS. HOWEVER, ONCE THE PROJECT IS COMPLETED, WOMEN ARE OFTEN FIRED REGARDLESS OF THEIR PERFORMANCE OR SKILLS. RESEARCH SHOWS THAT WOMEN IN CONSTRUCTION ARE LESS LIKELY TO HAVE ACCESS TO MENTORS WHO ACT AS CAREER PROMOTERS BY SIGNALING THE WOMAN’S POTENTIAL AND PROVIDING THE SUPPORT NEEDED TO ENSURE SUCCESS.”

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FOOD & BEVERAGE RETAIL MARKETPLACE DISRUPTION

BY ALEX CUVA WITH CONTRIBUTIONS FROM MICHAEL COLETTI

Competition to Meet Consumer Demand

As recently as the 1990s, traditional food stores (such as Publix, Stop & Shop, Kroger, Albertsons and Shoprite) accounted for roughly 90% of retail food sales. Today brick and mortar sales are only half of that figure, accounting for only 45% of all retail food sales. This shift is due to consumer demand for more options, better prices and greater convenience. Traditional food stores have been faced with market disruption from alternative channels such as Walmart, Target, Costco, Sam’s Club, boutique supermarkets, and online food delivery services. Industry reports forecast that by 2021, nearly one quarter of traditional food stores will no longer be around.

The biggest threat to traditional food stores is Walmart. In 2016, grocery sales in the United States were roughly $670 billion, with Walmart making up a staggering 17% of that figure. The retail giant has used its scale to offer low prices and convenience to consumers, and seeks to gain more market share through a number of innovations:

• 24 hour automated pickup locations where customers can quickly retrieve online orders;
• A program allowing in-store employees to sign up to deliver groceries to customers;
• Utilizing Uber to deliver groceries;
• The Scan & Go phone app, through which customers can scan products and pay, then show their digital receipt to a greeter and walk out, avoiding lines;
• Pairing with Google to interface with Google smart devices such as Google Home and,
• Offering discounts to online orders that are picked up in physical locations.

With all of these options, it is no wonder that Walmart’s online grocery business has grown 70% year over year. Both in-store and online grocery sales comprise nearly 50% of its US revenues.

Market disruption will certainly continue in the food & beverage industry going forward, with 62% of shoppers expressing a desire for an alternative to in-store grocery visits. The online grocery channel is expected to more than double by 2021, while traditional food stores are expected to decrease around 25%. With concepts like Amazon’s drone delivery service (where drones can deliver from warehouses to your home in less than 30 minutes) inching closer to reality, food retailers will be forced to innovate and create value for their customers or be left behind.

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However, the deep pockets and technological expertise of Amazon will keep food retail executives looking over their shoulders. For example, Amazon is experimenting with cashier-less stores where customers go in, grab what they want, and walk out with their goods, which are tracked and virtually ‘checked out’ using various sensors while a receipt is sent to the customer’s account. Amazon further threatens to disrupt the retail food industry in many ways:

• Utilizing Whole Foods’ locations for customers to pick up online orders;
• Offering ‘Instant Pickup’ locations where food staples can be ordered and ready in under 3 minutes;
• Offering Amazon Meal Kits, which directly threaten meal subscription services such as Blue Apron and HelloFresh;
• Offering special pricing and rewards programs to those with Prime accounts and,
• Utilizing their existing technological presence in tens of millions of homes (via Amazon Alexa) to interface with users and offer food ordering capabilities.

“THE FOOD DELIVERY RETAIL CHANNEL IS QUICKLY GROWING, WITH WALMART, AMAZON, STOP & SHOP, FAIRWAY AND COUNTLESS OTHERS JOINING IN. WITH THE RECENT ACQUISITION OF WHOLE FOODS, AMAZON INCREASED ITS DISTRIBUTION CHANNELS, FOOTPRINT AND PRODUCT OFFERINGS FOR ITS FOOD DELIVERY SERVICE. THOUGH THIS ACQUISITION CREATED MANY HEADLINES, IT IS REGARDED BY MANY IN THE INDUSTRY AS BEING NOTHING MORE THAN JUST NOISE IN THE SHORT TERM.”

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I’m not ashamed to admit that my life, like many of yours, has been made easier because of my iPhone. I use it for everything, and it does pretty much everything I need.

Today alone, I emailed a company’s CFO, set my fantasy baseball lineup, opened a door, and wrote part of this paragraph, all on my iPhone. I’m sure many of you probably do similar things, whether through your phone, tablet, or some other form of handheld technology. It’s the new normal. In order to remain competitive with the market, we need to adopt and continue to cultivate technology.

It’s how we do business – more devices, more access, more flexibility. However, as we continue to utilize technological tools in this fashion, we need to reflect on our preparedness to combat the threat of cybercrime.

It is no secret that the energy sector is a prime target for cyberattacks. Energy companies have everything that attackers are looking for: personnel files, bank accounts, billing addresses, the ability to shut down operations, and worse. So what are energy companies to do? Stop using technology? Absolutely not! But it is important what are energy companies to do? Stop using technology? Absolutely not! But it is important to reflect on our preparedness to combat the threat of cybercrime.

This is the new normal. In order to remain competitive with the market, we need to adopt and continue to cultivate technology.

Assessment questions should include:

1. Do we have a cybersecurity program that defines objectives for the organization’s cyber activities?
2. Is the program documented and does it match the objectives of the program with the company’s risk profile and infrastructure?
3. Is cybersecurity governance identified, documented, and promoted?
4. Does the program have the buy-in of senior management?
5. What programs and processes could potentially be under threat (asset and change management, logical access, and communication infrastructure)?
6. Do we have a dynamic operating environment?
7. How are incidents detected and responded to?
8. What are our dependency risks (external parties)?
9. How do we mitigate user risk?
10. The answers to those questions will allow you to identify gaps in your cybersecurity program.

Assessment results should be analyzed by individuals that have the specific skill set to perform the implementation and assignment. These individuals may be internal, but can also be external resources. It is important to note, that companies should consider consultation with a fiduciary for referrals and guidance, as such resources will be shaping your business objectives around cybersecurity.

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Management must buy into the process, as building effective cybersecurity is both costly and time consuming, both when fixing existing problems and when implementing new controls. Appropriately resources must also be assigned in order to address risk detection, mitigation, and any gaps. This may require resource availability for weeks, months, or years.

Once management has bought in and you have found your internal or external resources, the next step is making a plan. This will be the foundation supporting the program. To develop a mature program requires dedication and, potentially, a change in the way a company views the importance of cybersecurity. Once finalized, the plan should be implemented, tracked, and reevaluations performed in response to major changes in business and technology, through periodic review to ensure continuing compliance with company policy.

The last step is adaptation and continued enhancement. This requires dedication and the understanding that as cell phones and technology change, and your business and people become more autonomous, so does your enemy. It is important that you stay one step ahead. Cybersecurity risk must be part of enterprise risk management strategy. While the risk can’t be completely eliminated, by following the suggested procedures above, it can be monitored and mitigated through an informed decision-making process.

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The extent of the impact on an entity will differ depending on factors including the transaction, its complexity, and the industry in which the entity operates. In some cases, there may be no change to the amount and timing of revenue recognition. In other cases, there will be changes which could be significant.

The industries most affected will include telecommunications, aerospace, construction, real estate, and software.

New qualitative and quantitative disclosure requirements about revenue and contracts with customers will have an impact on almost all entities.

Impact on Not-For-Profits

The AICPA Not-for-Profit Revenue Recognition Task Force (NFP RRTF) has indicated a number of issues that could affect exempt organizations upon implementation of this standard:

- Contributions are excluded from the standard because a donor is not considered a customer as defined in the ASU.
- Certain transactions will require bifurcation between an exchange transaction and a contribution. For example, membership-dues or special events (for example, golf outings) may have elements of an exchange transaction and a contribution. Generally, the organization will determine the exchange component of the transaction under the new revenue recognition standard and apply contribution accounting to the remainder.

An area of continuing discussion in applying this new standard is accounting for private and government grants. Depending on the facts and circumstances, under the terms of some grant agreements, the government or other grantor may not be considered a customer because it is not receiving something of approximately equal value in return for the grant funds, but rather its constituents or society as a whole receive the respective value. Due to the new definitions related to revenue, NFPs implementing this standard may need to reevaluate their classification of grants between exchange transactions and contributions. These grants that previously fit the criteria of exchange transactions may better align with the definition of conditional contribution than that of a contract with a customer.

NEWS FLASH

On August 3, 2017, the FASB issued an exposure draft to clarify and improve the scope and the accounting guidance for contributions received and contributions made.

The amendment would assist entities in (1) evaluating whether transactions should be accounted for as contributions (nonreciprocal transactions) within the scope of Topic 958, Not-for-Profit Entities, or as exchange (reciprocal) transactions subject to other guidance and (2) distinguishing between conditional contributions and unconditional contributions.

This is of particular interest to entities which receive government grants and similar contracts with resources providers as noted above.

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WHAT IS THE “GAAP” IN REGARD TO DIGITAL CURRENCY?

BY LORENZO PRESTIGIACOMO

As digital currencies like Bitcoin, and its competitors like Ethereum and Ripple become more common in the business world, the Financial Accounting Standards Board (FASB) is conducting early stage research into whether to develop Generally Accepted Accounting Principles (GAAP) for these currencies. In 2013, the U.S. Financial Crimes Enforcement Network (FinCEN) defined virtual currency by contrasting it against “real currency.”

FinCEN stated: “regulations define currency (also referred to as “real” currency) as “the coin and paper money of the United States or of any other country that (i) is designated as legal tender and that (ii) circulates and (iii) is customarily used and accepted as a medium of exchange in the country of issuance.” In contrast to real currency, “virtual” currency is a medium of exchange that operates like a currency in some environments, but does not have all the attributes of real currency. In particular, virtual currency does not have legal tender status in any jurisdiction.”

As far back as 2014, the Financial Accounting Standards Advisory Council (which advises the FASB on various matters) discussed virtual currencies, measurement implications, etc. However, with virtual currency use increasing, inconsistent accounting practices are becoming a more urgent problem, particularly for those entities that are publicly traded and whose transactions are material to the financial statements. The FASB plans to discuss whether to add a project to its agenda at a future public meeting.

The acceptance of digital currencies is far from universal, and is even banned in some countries. However, over 100,000 merchants accept digital currency, including major companies such as Microsoft Corporation and Overstock.com. The Federal Election Commission also ruled that digital currency is considered a campaign contribution for federal elections.

Digital currency is also held as an asset by businesses and used for investment purposes, which similarly necessitates consistent accounting guidance. Per Reuters, the FASB is considering research following a letter from the Founder and President of the Chamber of Digital Commerce (“CDC”), a trade group representing the blockchain industry, dated June 8, 2017 to the FASB to clear up accounting questions in the growing digital currency market relating to the appropriate recognition, measurement, presentation and disclosure for digital currencies. It was stated in the letter that the absence of accounting standards for currencies is a mission critical issue for companies seeking to invest and innovate in this exciting technology frontier and the lack of them may hold back economic growth in the United States.

The CDC also has launched the Digital Assets Accounting Coalition (“DAAC”) which is comprised of accounting and technology professionals representing blockchain technology companies. The DAAC is developing accounting and reporting standards for digital assets, advocating for appropriate GAAP standards, and engaging with relevant standard-setting bodies. The DAAC regularly provides input to government organizations and industry associations such as the FASB and the American Institute of CPAs on the impact blockchain-based technologies may have on the future of accounting and auditing methods.

The CDC believes the FASB should develop an accounting model that would allow businesses to recognize digital currency when they control the associated economic benefits and measure the currency at fair value, with changes recorded in income. This is similar to a position the Australian Accounting Standards Board took in December 2016 when it presented a paper to the International Accounting Standards Board’s (IASB) main advisory panel, the Accounting Standards Advisory Forum, suggesting that the IASB investigate consistent accounting for digital currency. Also, with lack of guidance in international accounting standards, digital currencies were accounted for either under IAS 2, Inventory or IAS 38, Intangible Assets. The IASB Chairman Hans Hoogervorst said that the board would follow the developments in digital currency and keep it on the watch list.

Stay tuned for future updates on the status of the FASB’s deliberations regarding adding this project to their agenda, and any proposed Accounting Standards Updates, or guidance issued thereafter.

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Per the CDC, there are four distinct views on the treatment of digital currency. Some financial professionals believe digital currency should be accounted for under FASB Accounting Standards Codification (ASC):

- ASC 365, Cash and Cash Equivalents, or
- ASC 825, Financial Instruments, or
- ASC 360, Intangible Assets – Goodwill and Other, or
- ASC 330, Inventory

The conflicting treatments and lack of authoritative accounting guidance has led to confusion among auditors and/or the users of financial statements like investors and shareholders. The FASB is separately considering whether it should take on the broader issue of accounting for intangible assets, and could address digital currency within its work for that guidance.

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Online Marketplace Sellers: Voluntary Disclosure Program Available Through October 17, 2017

By Harold Hecht, Seth Rabe and Katie Massey

As highlighted in our recent article in the Mazars Ledger, “Vendors Beware! Fulfillment By Amazon Can Create State Tax Headaches”, online vendors using services such as Fulfillment by Amazon (FBA) could have additional state tax collection and filing obligations as the result of maintaining inventory at the online marketplaces’ warehouses throughout the U.S. The Multistate Tax Commission (MTC) is now offering a voluntary disclosure program for online marketplace sellers in which, as of August 18, 2017, 24 states including the District of Columbia are participating fully or in part. The program will waive unpaid tax, penalties and interest for both income/ franchise and sales/use tax. While a typical voluntary disclosure relief initiative would only limit lookback and waive penalties related to unpaid tax obligations, the MTC is providing a unique opportunity for those selling online via platforms like Amazon and other marketplaces to transition into state tax compliance, while removing the burden of back tax liability (however some states, as noted in the “Participating States” section below, are not waiving back taxes). Taxpayers can apply to the program anonymously and will not be required to disclose their identity until the voluntary disclosure agreement is executed. The program is available to eligible online marketplace sellers between August 17, 2017 and October 17, 2017.

Eligibility Criteria

Taxpayers electing to participate in the Voluntary Disclosure Initiative cannot have previously registered with the state taxing authority, filed returns for the tax type in which the taxpayer is seeking voluntary disclosure relief, made any payments related to the tax, or had any correspondence with the state regarding a potential liability for the tax type. The taxpayer must be an online marketplace seller using a service such as FBA or a similar platform to facilitate retail sales into a state in which it has no location, property, employees, or agents except for inventory in a third party warehouse or fulfillment center.

Application Process

Applications must be submitted between August 17, 2017 and October 17, 2017. Applications must state that the taxpayer is applying for voluntary disclosure relief under the online marketplace seller initiative and provide complete and accurate disclosure of the information requested. Online marketplace sellers must include an estimate of back tax liability to the state for the prior 4 years. Applications in which the estimated back tax liability is less than $500 will still be considered for the online marketplace seller initiative even through the application states otherwise. Taxpayers can select if they would like to participate in the voluntary disclosure relief program for sales/use tax, income/franchise tax, or both. By participating in the program, taxpayers are agreeing to begin collecting and remitting sales & use tax, beginning no later than December 1, 2017 and, if subject to income/franchise tax, the taxpayer further agrees to timely file income/franchise returns and pay such taxes due, commencing with the tax year including the effective date (not later than December 1, 2017) of the voluntary disclosure agreement.

The states participating in this special time-limited voluntary disclosure initiative have agreed not to disclose to other taxing jurisdictions the identity of any taxpayer entering into a voluntary disclosure agreement under this special time-limited initiative, except as required by law, pursuant to a court order, or in response to an inter-governmental exchange of information agreement in which the requesting entity provides the taxpayer’s name and taxpayer identification number. Blanket requests from other jurisdictions for the identity of such taxpayers will not be honored.

Participating States

Seventeen states will be fully participating in the Online Marketplace Seller Voluntary Disclosure Initiative to the full extent laid out by the Multistate Tax Commission: Alabama, Arkansas, Connecticut, Florida, Idaho, Iowa, Kansas, Kentucky, Louisiana, Missouri, New Jersey, North Carolina, Oklahoma, Tennessee, Texas, Utah, and Vermont.

An additional seven states will participate with modifications:

- Colorado will waive any back tax liability for sales/use tax, but will not waive back tax for income/franchise tax beyond its normal four year lookback period.
- C’s standard lookback period is 3 years for sales/use and income/franchise tax. D.C. will consider granting shorter or no lookback period for applications received under this initiative
- Massachusetts requires compliance with its standard 3-year lookback period; this lookback period in a particular case may be less than 3

Due to these increasing numbers, in 2018, the IRS will ask tax professionals to gather additional information on their business clients. In order for the IRS to verify that the tax return being submitted is legitimate and not an identity theft return, new information may be asked when filing a business tax return. Some of the required verification items include:

- Name & social security number of the company officer authorized to sign the business return. Is the person signing the return authorized to do so?
- Tax payment history – Were estimated tax payments made? If yes, when were they made, how were they made, and how much was paid?
- Parent company information – Is there a parent company? If yes, who?
- Additional information on deductions claimed.
- Filing history – Has the business filed Form(s) 940, 941 or other business related tax forms?

Although these verification items may modestly increase the time required to file business tax returns, they will hopefully reduce the potential for identity theft and its related costs.

Please contact your Mazars USA professional for more information or to learn more about how Mazars USA can help with your cyber security needs.

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years, depending on when vendor nexus was created.

- Minnesota’s customary lookback period is 3 years for sales/use tax and 4 years (3 look-back years and 1 current year) for income/franchise tax. Minnesota will grant shorter lookback periods to the extent when the marketplace seller created nexus.
- Nebraska will consider waiving back tax liability for sales/use tax and income tax.
- South Dakota does not impose income tax.
- Wisconsin will require payment of back tax and interest on any liability related to tax periods beginning January 1, 2015 and thereafter for both income/franchise tax and sales/use tax.

In Summary

Online marketplace sellers often have unaddressed tax obligations, particularly related to Fulfillment by Amazon and other online marketplaces. The participating states are offering a unique, time-limited program to assist companies in complying with their state tax obligations. Please contact your Mazars USA professional or our State & Local Tax Services team for consultation on any questions regarding state and local tax requirements.

IRS ANNOUNCES HURRICANE HARVEY RELIEF

PUBLISHED ON SEPTEMBER 12, 2017

By Eduardo Chung

As it has done in the past with other natural disasters, the Internal Revenue Service ("IRS") has announced relief provisions that will be available to Hurricane Harvey victims. The relief provisions apply to individuals who reside in or have a business in the following counties:


The above list of counties is as of September 5, 2017.

Individuals who live, and businesses whose principal place of business is located, in the covered disaster area will have an extended period of time to file most tax returns that have either an original or extended due date occurring on or after August 23, 2017 and before January 31, 2018. Tax returns (such as individual, corporate, and trust and estate income tax returns; partnership returns, S corporation returns, estate, gift and generation skipping transfer tax returns; and employment and certain excise tax returns) due during this period will now be due by January 31, 2018. The due date for estimated income tax payments falling in the period between August 23, 2017 and January 31, 2018 has also been extended until January 31, 2018. The IRS is applying this relief automatically by identifying taxpayers in the covered disaster area. Taxpayers affected by Hurricane Harvey who reside, or have a business located, outside the covered disaster area must call the IRS disaster hotline to request this relief. Additional information can be found in IRS News Release TX-2017-9.

The IRS has also announced relaxed rules for qualified plans making hardship distributions to families that have been affected by Hurricane Harvey. Some of the relief provisions include exemption from verification procedures of hardship, removal of prohibitions on post contributions after a hardship distribution and the ability to make the distributions prior to amendment of the plans. To take advantage of this relief, the distributions must be made by January 31, 2018. The Department of Labor has also announced it will follow the provisions of this IRS announcement. More details can be found in IRS Announcement 2017-11.

In summary, the IRS has also announced additional relief rules. To see these rules, please contact your Mazars USA professional for additional information.

IRS ANNOUNCES HURRICANE IRMA RELIEF

PUBLISHED ON JULY 24, 2017

By Eduardo Chung and Michael Kim

The Internal Revenue Service ("IRS") has announced relief provisions that will be available to Hurricane Irma victims. The tax relief parallels the relief recently granted to victims of Hurricane Harvey (see our previous Tax Alert dated September 12, 2017), and apply to individuals who reside in or have a business in the following Florida counties:

- Brevard, Broward, Charlotte, Clay, Collier, Duvall, Flagler, Hillsborough, Lee, Manatee, Miami-Dade, Monroe, Palm Beach, Pinellas, Polk, Putnam, Sarasota, St. Johns and St. Lucie.

The relief provisions also apply to the islands of St. John and St. Thomas in the U.S. Virgin Islands and the municipalities of Culebra, Vieques, Canovanas and Loiza in Puerto Rico.

The above list is as of September 13, 2017. The list may be updated in the future and can be found on the disaster relief page on IRS.gov.

Individuals who live, and businesses whose principal place of business is located, in the covered disaster area will have an extended period of time to file most tax returns that have an original due date occurring on or after September 4 (in Florida) or September 5 (in Puerto Rico and the Virgin Islands). Tax returns (such as individual), corporate, and trust and estate income tax returns; partnership returns; S corporation returns, estate, gift and generation skipping transfer tax returns; and employment and certain excise tax returns) originally due on or after those dates will now be due by January 31, 2018. The due date for estimated income tax payments falling in the period between September 4 or 5 and January 31, 2018 has also been extended until January 31, 2018.

The relief also applies to 2016 individual income tax returns that were extended until October 15, 2017. However, because the payments related to these 2016 returns were originally due on April 18, 2017, those payments are not eligible for relief. Entities, such as calendar year partnerships, that have extended tax returns due during this period will also have additional time to file their respective returns.

The IRS is applying this relief automatically by identifying taxpayers in the covered disaster area. Taxpayers affected by Hurricane Irma who reside, or have a business located, outside the covered disaster area must call the IRS disaster hotline to request this relief. Additional information can be found in IRS News Release IR-2017-150.

FinCEN has also announced that victims of Hurricane Irma in affected areas of Florida, Puerto Rico and the U.S. Virgin Islands will have until January 31, 2018 to file their 2016 Report of Foreign Bank and Financial Accounts (FBAR). In addition, FinCEN will work with any FBAR filer who lives outside the disaster area, but whose records required to meet the deadline are located in the affected area, regardless of where the filer resides. FBAR filers who live outside the affected area and need assistance meeting their filing obligations should contact the FinCEN Resource Center at 800-767-2825 or frc@fincen.gov.

The IRS has also announced relaxed rules for qualified plans making hardship distributions to families that have been affected by Hurricane Irma. Some of the relief provisions include exemption from verification procedures of hardship, removal of prohibitions on contributions after a hardship distribution and the ability to make the distributions prior to amendment of the plans. To take advantage of this relief, the distributions must be made by January 31, 2018. The Department of Labor has also announced it will follow the provisions of this IRS announcement. More details can be found in IRS News Release 2017-151 and IRS Announcement 2017-13.

It is anticipated that various states will provide additional Hurricane Irma relief.

Please contact your Mazars USA professional for additional information.
By Richard Bloom, James Wiencw, Tifphani White-King, Cody Cass, Irina Razumovskaya And Joshua Zimmerman

The Trump Administration recently released its tax reform proposal, named the “Unified Framework for Fixing Our Broken Tax Code.” The framework was the result of many discussions and meetings over the past few months led by the so called Big Six – Treasury Secretary Steven Mnuchin, National Economic Director Gary Cohn, House Ways and Means Committee Chairman Kevin Brady (R-TX), House Speaker Paul Ryan (R-WI), Senate Majority Leader Mitch McConnell (R-KY), and Senate Finance Committee Chairman Orrin Hatch (R-UT).

The framework provides significant tax rate cuts for corporations and pass-through entities, a reduction of the number of individual income tax brackets, enhanced expensing for certain corporate deductions, elimination of certain individual itemized deductions, repeal of the individual and corporate alternative minimum tax, repeal of the estate and generation skipping transfer tax, and a move to a territorial taxation system for corporations, with a one-time repatriation tax. The framework, however, does not provide many details underlying these general concepts.

According to the document released by the Trump Administration, the framework aims to meet the following four principles:

- “Make the tax code simple, fair and easy to understand;
- Give American workers a pay raise by allowing them to keep more of their hard earned paychecks;
- Make America the jobs magnet of the world by leveling the playing field for American businesses and workers; and
- Bring back trillions of dollars that are currently kept offshore to reinvest in the American economy.”

**INDIVIDUAL TAX PROVISIONS**

**Individual Tax Brackets.** Individuals are currently subject to a tiered income tax structure with seven increasing tax rates based upon income level – with a maximum income tax rate of 39.6%. The framework reduces the tiered tax rate structure to three income tax rates – 12%, 25% and 35%. There is arguably a fourth tax rate, 0%, for those with taxable income below the proposed standard deduction (discussed below). It is interesting to note that the framework indicates that an additional top rate may apply to the highest income taxpayers, to ensure that the reformed tax code is at least as progressive as the existing tax code and does not shift the tax burden from high income to lower and middle income taxpayers. Neither the potential additional top rate nor the tax brackets were detailed in the framework.

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The inclusion of the potential for an additional top income tax rate opens the window for more negotiation between the various parties charged with turning the framework into law. Although the framework reduces the top income tax rate and the number of income tax brackets, the lack of details prevents taxpayers from fully analyzing the impact on their individual situation. Also notably absent from the framework was any mention of a change in the capital gains tax rate.

**Standard Deduction.** The framework replaces the current standard deduction and personal exemption with a new standard deduction for both single and married individuals filing jointly. The new standard deduction is $24,000 for married taxpayers filing jointly and $12,000 for single filers.

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The higher standard deduction may eliminate the necessity of itemizing deductions for some taxpayers. Without the need to itemize their tax deductions, taxpayers may alter those spending and charitable giving habits that were, at least partially, based upon tax benefit. This could affect both charities and the real estate market because mortgage interest and charitable contributions may not be as valuable as they are currently.

**Itemized Deductions.** The framework proposes to eliminate most itemized deductions other than home mortgage interest and charitable contributions. This apparently means that the deduction for state and local income taxes is eliminated. Representatives of high income tax states such as New York and New Jersey have already voiced their opposition to this provision.

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If the deduction for state and local income taxes and miscellaneous itemized expenses are eliminated, the effect of the repeal of alternative minimum tax may not be very significant for a majority of those affected.

**Death and Generation Skipping Transfer Taxes.** The estate tax rate is repealed. The framework does not mention gift taxes so it is expected that the gift tax will not be repealed. The framework also does not mention anything regarding the basis step up at death or a capital gains tax to be paid at death or by a beneficiary based on the unrealized gain inherent in a decedent’s assets.

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Retaining the gift tax prevents taxpayers from removing assets from their estate in order to avoid a potential capital gains tax at death.

**Enhanced Child Tax Credit and Middle Class Tax Relief.** The framework repeals the personal exemption for dependents and increases the Child Tax Credit. It does not indicate the amount of the Child Tax Credit, but it indicates that the first $1,000 will still be refundable. It provides for an increase in the income levels at which the Child Tax Credit begins to phase out, thereby making the credit available to more middle income families, and it eliminates the marriage penalty in the existing credit. The tax writing committees are responsible for working on additional measures to meaningfully reduce the tax burden on the middle class.

**DOMESTIC CORPORATE TAX PROVISIONS**

**Corporate Tax Rate Reduction & Elimination of Corporate AMT.** The proposed tax framework calls for a reduction in the top corporate tax rate from 35% to 20%. The framework notes that the average corporate tax rate in the industrialized world is currently 22.5% and cites the comparatively high corporate rates in the US as a contributing factor to job losses and lower wages in the US. The framework proposes to mitigate these effects by reducing the corporate tax rate below the international average. Consideration will also be given to reducing the burden of double tax on undistributed C Corporation earnings. Consistent with these objectives, the framework also proposes full repeal of the Corporate Alternative Minimum Tax, or “AMT.”

**Flowthrough Rate Reduction.** The framework proposes a 25% tax rate to apply to all income earned by small businesses organized as sole proprietorships, partnerships, LLCs, S Corporations, or similar flow-through entities. This would reduce the federal income tax burden on many small businesses, in an effort to spur job growth and the economy generally.

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The reduced rate for flowthrough income would also eradicate existing
tension with the IRS concerning compensation paid to owners of flowthrough entities, particularly S Corporations. Currently, the IRS takes the position that owners of S Corporations must be paid reasonable compensation for their services to protect the payroll tax base. A differential in the income tax rate between flowthrough income and earned compensation would give the IRS even greater incentive to challenge the amounts paid to flowthrough owners.

**Current Deduction for Capital Investments.** The framework would allow businesses (regardless of tax classification) to claim a current deduction for new investments (after September 27, 2017) in capital assets, in lieu of the current regime of bonus, accelerated, and ordinary depreciation deductions provided under the Code. Investments in real property are not eligible to be immediately expensed under the framework.

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The framework aims to provide an “unprecedented” tax benefit for capital investments, both in terms of the duration of the benefit and scope of assets covered. Prior tax incentives have allowed temporary “100% bonus” depreciation deductions. It is not clear whether the deduction for capital investments will be made a permanent part of the business tax provisions, but the framework suggests it will at least eclipse the duration of these prior programs.

**Interest Expense.** The deduction for net interest expense may be partially limited for C Corporations under the terms of the framework. The framework contemplates that a similar limitation may be put in place for other businesses. Details concerning this provision have yet to be determined.

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Eliminating or limiting the deduction for net interest expense would reduce the incentive to capitalize C Corporations with shareholder debt as opposed to equity contributions. This may help both to simplify the tax code and to protect the corporate tax base from erosion through leveraging up otherwise profitable businesses with shareholder debt. However, it remains to be seen what will happen with interest expense attributable to existing debt arrangements. Furthermore, we may see a decrease in acquihire transactions and other types of business succession planning.

**Repeal of Deductions and Credits.** The framework contemplates that the reduction in rates will be partially funded through the repeal of certain business deductions and credits. Specifically, the Domestic Production Activities Deduction contained in current Code Section 199 would be eliminated under the framework. Other deductions and credits may also be repealed.

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The Section 199 deduction and various credits targeted for repeal are intended to incentivize certain industries, such as manufacturing operations. With the proposed reduction in business tax rates, these special incentives seem to be viewed as unnecessary or redundant. The framework notes, however, that the research and development and low-income housing credit should be preserved due to their positive impact on the US economy.

Along similar lines, the framework calls for the review and revision of tax regimes that apply only to certain industries in order to modernize the tax code and reduce opportunities for tax avoidance. Specifics concerning the industries affected and the criteria for reform, however, are not discussed.

**International Corporate Tax Provisions.**

Significant changes were proposed with respect to international corporate taxation.

**Territorial Tax System.** The administration proposed the introduction of a territorial tax system for corporations to replace the current worldwide profit taxation principle. Further, there is a complete tax exemption for dividends received by US companies from their foreign subsidiaries, provided there is a minimum 10% participation.

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The proposed switch to the territorial tax system comes as no surprise and is in line with the initial suggestions by the Trump Administration.

While transition into a territorial tax system combined with a reduction in domestic corporate taxes to 20% is regarded by many as a welcome move, it is sure to create a great degree of, at least temporary, uncertainty. Without a doubt, the tax reform will necessitate special transition rules and provisions, especially as it concerns previously accumulated foreign earnings.

Currently, US multinationals structure their operations differently using either tax transparent entities (LLCs, Partnerships), or tax opaque entities (Limited Companies, Corporations) or even hybrid entities (transparent in one jurisdiction, opaque in another). Furthermore, significant planning goes into determining a proper tax efficient combination of debt and equity in financing of their foreign operations. Transition into a territorial tax system and a zero dividend tax may put some existing tax structures at a disadvantage while creating new loopholes for others. Coordination may be necessary between taxation of profits received through various types of entities and instruments.

One Time Offshore Profits Repatriation Tax. A one-time repatriation tax on profits accumulated offshore is being introduced. Previously accumulated foreign profits will be deemed repatriated and taxed at different rates according to the type of assets: a higher tax rate will apply to cash and other liquid assets, and a lower tax rate will apply to all other illiquid assets. The payment of repatriation tax will be spread over an unspecified period of time.

In professional circles, it is suggested that this period may be anywhere from five to eight years.

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Coordination with Anti-Tax Deferral Regimes is necessary. Today, US multinationals are taxed on their worldwide profits and are subject to various anti-tax deferral provisions. One set of such rules is referred to as Controlled Foreign Corporations (“CFC”) regime. The CFC regime imposes taxation on certain passive income and related party income of foreign subsidiaries, even in the absence of dividend distributions. CFC regime taxation thus only captures certain types of income that are notorious for being prone to tax avoidance techniques. The CFC rules do not normally affect the course of businesses’ foreign profits. It is unclear whether the repatriation tax will be applied to all, or only to certain types of foreign accumulated earnings.

Anti-Base Erosion and Profits Shifting Provisions. Anti-base erosion and profit shifting provisions will be enhanced in order to put US multinationals on par with their foreign counterparts and assure the effectiveness of the new territorial tax system. There are not many details available as to what specific anti-avoidance mechanisms would apply.

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It is likely that the methods suggested by the Organization for Economic Cooperation and Development (OECD) under the Base Erosion and Profit Shifting initiative (BEPS) framework may be implemented in the US. If this is the case, it may create additional information and reporting compliance obligations for the multinationals. If not coordinated with the existing obligations, it may defeat the goal of the administration to minimize and simplify the reporting burden.

The tax writing committees must now take this guidance and turn it into legislation. We will continue to monitor the progress of tax reform. Please contact your Mazars USA LLP professional for additional information.

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The Media, Information and Technology Group at Mazars USA LLP was pleased to assist Connectiv, The Business Information Association division of SIIA, which is the leading trade association for companies involved in the creation and delivery of business information, in the development and completion of its 2017 Survey of basic financial metrics relating to its members’ recent and projected results. The 23 CFO respondents were a good representation of companies balanced between those over and under $50 million in annual revenue, as well as being geographically dispersed throughout the U.S.

While only 48% of respondents reported that their revenues and EBITDA had increased from 2015 to 2016, 91% of those same companies projected that revenue would increase in 2017 over 2016 and 74% projected increases in EBITDA for that same period. Clearly, there is optimism about the future.

We also found that, comparing 2015 to 2016, the business centers contributing to the total revenue mix (consisting of print advertising, paid content and information services, marketing services, events and digital) were consistent year over year with paid content/information services showing some growth. And, in spite of a generally pessimistic perception of print advertising, that business center represented over 30% of respondents’ revenue in 2016 – only 1% lower than 2015.

The respondents also reported that digital services, including websites, native advertising, e-newsletter lead generation, mobile apps, mobile delivery and subscriptions, resulted in an average contribution margin of 65% – the highest of the reported business centers. Our experience serving this industry has shown that there is a wide disparity in the way companies allocate costs to their various business centers, creating possible distortion of the actual business segment performance. We recommend that all companies evaluate their cost allocation methodology to assure that the results for digital operations are representative of the segment’s contribution margin.

The survey also asked about the length of time required to prepare unaudited year end financials. Of the 23 respondents, 8 indicated that such preparation exceeded 60 days, of which 6 were respondents reporting less than $50 million in annual revenue. Our experience in this area has indicated a strong correlation between rapidity of closing the books and profitability. We strongly encourage management to put in place the investments, controls and discipline to complete the closing and reporting process within 45 to 60 days.

The survey results indicate that companies are evolving along with the ways in which their audiences are consuming information, finding new ways to interact with users. This is confirmed by greater allocation of capex expenditures to both information services and digital business segments. Being in the forefront of changing product and consumption behavior will serve this industry well. As Henry Ford said, “If I'd asked people what they wanted, they would have said faster horses.” We thank SIIA/Connectiv for permitting us to participate in this effort.
MAZARS CAN SEE 8 QUARTERS INTO THE FUTURE.

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