SPRING 2015

Leading EDGE

Kreischer Miller

PEOPLE | IDEAS | SOLUTIONS

ADVICE & INFORMATION TO HELP YOU MANAGE YOUR BUSINESS

IN THIS ISSUE

Executive Compensation Trends in 2015

Tyler A. Ridgeway
Director
Human Capital Resources

Through the course of my interactions with more than 100 business owners over the last six months, I have heard some common messages. Businesses have weathered the storm of several years ago. They have emerged as better run companies with greater cash reserves. Now they are wondering what to do with that extra cash. Options include pursuing an acquisition, developing a new product line, upgrading executive talent, or distributing it as bonus compensation to key employees.

Let's focus on that last option.

Compensating Your Top Performers

From a cash perspective, we highly recommend performance-based bonuses as a key way to compensate your top performers. Today's executives are being measured more by the value they create for the company's owners than by simply getting the job done. We encourage owners and CEOs to create measurable, achievable benchmarks for key executives that can be monitored in a relatively easy and efficient manner.

We are seeing a growing trend toward the creation of bonus and/or cash pools to properly incent top performers as the company grows. Companies are also increasingly using alternatives like phantom stock plans and stock appreciation bonuses that put a percentage of increased revenues over a specified time period into an executive's retirement plan. With these plans, the executive does not own equity in the company, but shares part of the increase in value. These vehicles reward executives for growth and profits with a focus on specific goals and objectives that need to be accomplished.

Transparency is vital with these arrangements. Owners need to be more willing to communicate the company's cash position to key executives on a regular basis. That way, you can avoid surprises and everyone will understand why bonuses are down when the company has not had a great year. The philosophy should be that if everyone is rowing in the same direction, everyone will win.

Attracting "A" Players in a Talent War

Mid-market companies realize there is a talent war and know they need to pay for top talent. I recently attended a seminar featuring a highly respected economist. He mentioned two trends that we have been talking to our clients about for the past two years. First, when looking for new executive talent, please know that "A" players have many more employment options than in previous years. "A" players control some of the hiring leverage and will be interviewing you as much as you are interviewing them.

Second, these "A" players are being heavily recruited because there is currently a smaller supply of qualified candidates. To successfully attract top talent to your organization, you must be willing to offer above average salaries.

However, many executives do not yet realize that they will increasingly be asked to share in a company's risk. One way to ensure your new hire will have some "skin in the game" is by offering a package with a very competitive salary along with a strong performance-based bonus and upside compensation. As the executive positively impacts the company and its bottom line, you can easily measure his or her contribution and distribute profits accordingly. **LE**

Cyber Risks and Theft –

What You Need to Know

Richard Snyder
Director
Audit & Accounting

Hardly a week goes by without a headline about a corporate cyber attack. We most often hear about large, well-known companies like Sony, Target, and Home Depot. There are many incidents of cyber attacks and cyber theft that do not make the news, but they still greatly impact companies and government agencies of all shapes and sizes.

Cyber threats have grown exponentially over the last few years. Cyber attackers have become more technologically sophisticated and have outpaced the IT security systems many businesses have implemented. Additionally, the increased use of mobile technology and cloud computing has made information more readily available to unauthorized users.

An organization's management and board of directors are responsible for its cyber security, but it can be easy to overlook this task. But with the growing number of cyber attacks and the increasing risks to every organization, cyber security is quickly becoming a top priority for many CEOs and CFOs.

The consequences of cyber theft and crimes are numerous. These incidents often find their way into the headlines given their high impact, and the negative publicity can cause lasting reputational harm to your organization. Cyber security breaches can result in the loss of vital company information, and confidential employee and client information can be exposed to hackers or the public. Moreover, security breaches can damage your systems, resulting in a disruption or interruption of everyday operations.

Cyber crimes and theft can also be costly. Security breaches can require repairs to computer systems, websites, and networks, and external consultants and advisors may be needed to get your systems operating properly again. If your system is down for significant periods of time for repair or reactivation, the result can be lost production and opportunity costs. There can also be high legal costs stemming from litigation from customers, vendors, or personnel whose information has been compromised. For instance, Home Depot's annual report disclosed that the company is facing more than 40 civil suits due to its 2014 data breach.

So how can you deal with cyber risk? First, your board of directors and management team need to become better educated about the perils of cyber crimes and theft, and identify risks that can potentially impact your company. These risks can include wire fraud, phishing scams, malware, and exposure of employee emails, company financial and proprietary information, and confidential client and vendor information.

Once you identify your risks, develop standards, best practices, and written policies and procedures to address them. Employee education and a heightened awareness of cyber risks (e.g. phishing scams) can go a long way toward preventing security breaches. Also, develop a recovery action plan to contain the damage and limit disruptions to your operations in the event that a cyber security breach does occur. You may need to consult outside experts to help identify and address your risks if do not currently have this expertise on your team. You should also discuss cyber risks with your insurance company to determine which crimes and thefts are covered under your existing commercial policies. Insurance carriers may exclude certain cyber attacks such as data breaches or require specific cyber crime coverage.

We have daily reminders of the damage that cyber theft and security breaches can inflict on businesses and individuals. Be proactive in understanding the cyber risks that impact your business and operations so you can adopt practices, policies, and procedures to help prevent an attack. **LE**

S Corporation vs. LLC – Which Structure is the Right Choice for Your Business?

Jeffrey W. Clark
Manager
Tax Strategies

Every new business owner faces the daunting task of choosing which type of entity structure best fits their business. S corporations and Limited Liability Companies (LLCs) both provide for the owner's protection from creditors related to the debts of the business as well as liability from the actions of the other owners or shareholders. Plus, many small business owners prefer the flexibility of pass-through taxation provided by S Corporations and LLCs. But while taxation plays a large role in entity determination, it should not exclusively be the determining factor. Here are some of the key tax and nontax considerations when deciding on an entity structure.

Ownership Structure

S Corporations are limited in number and type of owner. Only U.S. citizens and residents can be owners of an S corporation. Additionally, the number of shareholders is limited to 100. For purposes of this limitation, a husband and wife are treated as one owner. Estates and certain trusts are permitted to own shares in an S corporation.

LLCs have significantly fewer restrictions when it comes to ownership. While an LLC owned by one person is disregarded for tax purposes, LLCs can have an unlimited number and type of owners. The default tax classification for a multi-member LLC is a partnership.

Owner Compensation

Compensation of owners working in S corporations and LLCs is another area of differentiation. S corporation shareholders actively working in the business are employees of the entity and should be compensated as such. Accordingly, the S corporation will pay the shareholder-employee a salary and withhold income taxes and Social Security. The shareholder-employee will then be issued a W-2 at the end of the year.

This raises the issue of reasonable compensation. How much salary should an S corporation shareholder be paid versus allowing the profit of the company to pass through

continued on following page

continued from previous page

to their personal tax return as reported on their Schedule K-1? A number of factors should be considered when determining whether a salary is reasonable, such as the hours worked, services rendered, and industry guidelines.

Conversely, LLC members are treated as partners in a partnership and cannot be paid a salary. Payments for services rendered would be treated as guaranteed payments, which are a means of paying a preferential allocation of profits to a particular LLC member. Guaranteed payments and net profits from an active trade or business conducted by the LLC would be subject to Self-Employment Tax. While S corporation shareholders can possibly satisfy their federal income tax liability through payroll withholding, LLC members are required to pay quarterly estimated taxes.

Income and Loss Allocation

The allocation of income and losses to S corporation shareholders is more restrictive than that of LLC members. S corporations are limited to one class of stock. Income and losses from S corporations are allocated on a per share, per day basis. Any preferred allocation could be deemed to be a second class of stock and invalidate the company's S election. Voting and nonvoting common stock are considered one class for this purpose.

LLCs offer greater flexibility when it comes to allocation of profits and losses. Any method that has substantial economic effect is permissible.

Pass-Through Loss Deductions

Owners are limited to deducting pass-through losses up to the amount of their basis. Losses in excess of basis are suspended and carried forward until the owner's basis has been restored. LLC owners are at an advantage in this regard. They are able to include in their basis their proportionate share of the debts of the company.

S corporation shareholders do not have this ability even if they have signed a personal guarantee. An S corporation shareholder can only increase their basis relative to a loan they have actually repaid or monies they have loaned to the company. Those who have used their debt basis to deduct losses are often surprised to learn that the repayment of personal loans can be recaptured as ordinary income.

When choosing an entity structure, business owners should consider both short and long range plans for their business venture. One size does not always fit all. LLCs can offer more flexibility and less administrative burden for a small business just starting out. If future events necessitate a change, it is much easier to move from an LLC to an S corporation than vice versa. A change from an S corporation to an LLC could result in a taxable event for the owners.

Please contact any member of Kreischer Miller's Tax Strategies group for assistance with choosing the entity type that best fits your business goals. **LE**

5 Manufacturing Trends for 2015 and Beyond

Brian J. Sharkey
Director
Audit & Accounting

As manufacturers continue to recover from the Great Recession, here are five current and projected trends for the manufacturing sector.

Capital Investment

The Philadelphia Federal Manufacturing Activity Index has reported twelve consecutive months of growth. Companies are seeing production increases along with increased optimism.

As manufacturers approach 80 percent production capacity, they begin to contemplate the need to bring on a new shift or invest in capital expenditures. Both options have positive impacts on the economy; however, companies are increasingly opting to make capital investments in new machinery or advanced technology rather than increasing their workforce. Kreischer Miller's 2015 Greater Philadelphia Manufacturing Survey recently found that 61 percent of respondents noticed an increase in profitability from investments in capital equipment, while 53 percent noticed improvements from investing in their workforce.

Next-Shoring

Over the past few years, we've heard a lot about re-shoring. Rising freight costs and increased wage pressure have made the Asian market less attractive for domestic manufacturers. As a result, many are now considering next-shoring to be the next best option.

Sourcingmag.com defines next-shoring as

"the transfer of business or IT processes to companies in a nearby country, often sharing a border with your own country."

By relocating all or components of manufacturing operations to a closer location, companies can remain competitive with reduced lead times, comparable (or, in some cases, lower) labor costs, and fewer time zone issues.

Technology

Today's manufacturing economy is driven by constant innovation. Innovation leads to improved processes, a safer manufacturing facility, increased output and, ultimately, increased enterprise value. Right now, robotics are at the forefront of manufacturing innovation.

Robots can be used to replace many of the tedious and potentially dangerous jobs currently performed by non-skilled labor. It is no secret that robotics will eliminate certain manufacturing jobs, but these jobs will be offset by new opportunities, such as maintaining and monitoring the robots. These new jobs will require additional training, resulting in the need for a more skilled workforce.

Internet of Things

The Internet of Things (IoT) is the concept that objects and people are connected via the use of embedded computing devices within the existing Internet infrastructure. The development of IoT within the manufacturing industry is a critical element of a more efficient means of production.

Currently, manufacturing processes do not communicate as well as they should. Many involve machines that run continuously, regardless of how other machines (input or output) are operating. As you can imagine, it is difficult to have all equipment operating at the same output level all of the time. IoT allows individual processes and machines to speak to each other through the use of various sensory devices.

IoT can go a long way toward improving efficiencies and reducing cost by providing real-time monitoring from anywhere in the world. And with the growth of consumer-based IoT products, the cost of microprocessors, sensors, and related wireless devices has become cheaper – making this a trend we expect to continue.

Green Sustainable Manufacturing

Organizational stakeholders are becoming increasingly aware of their responsibility to the environment and are asking, or in some cases, requiring their companies to become more environmentally friendly. According to the Institute of Defense Analysis's Emerging Global Trends in Advanced Manufacturing,

"Advanced manufacturing processes will likely be more energy and resource efficient in the future, as companies strive to integrate sustainable manufacturing techniques into their business practices to reduce costs, to decrease supply-chain risks, and to enhance product appeal to some customers."

With the right leadership and clearly defined objectives, green sustainable manufacturing holds potential economic benefits including long-term cost savings, waste reductions, and process efficiency improvements.

To receive a copy of Kreischer Miller's 2015 Greater Philadelphia Manufacturing Survey, contact Brian Sharkey at bsharkey@kmco.com. **LE**

LEA global

leading edge alliance

innovation • quality • excellence

Kreischer Miller is a member of the Leading Edge Alliance. Members are leaders in many key markets, including:

Alabama
Albania
Afghanistan
Argentina
Atlanta
Australia
Azerbaijan
Bahrain
Baltimore
Bangladesh
Belgium
Bolivia
Boston
Brazil
British Virgin Islands
Buffalo
Bulgaria
Cayman Islands
Chattanooga
Chicago
Chile
China
Cincinnati
Cleveland
Colombia
Croatia
Cyprus
Czech Republic
Dallas
Dayton
Denver
Dominican Republic
Ecuador
Egypt
El Salvador
Finland
Fort Lauderdale
Ghana
Germany
Greece
Guatemala
Harrisburg, PA
Hartford
Hong Kong
Honolulu
Houston
Hungary
India
Indiana
Indonesia
Iowa
Ireland
Israel
Italy
Jordan
Kansas
Kazakhstan
Kenya
Knoxville
Korea
Kuwait
Las Vegas
Latvia
Lebanon
Lexington
London
Los Angeles
Luxembourg
Macedonia
Madison, WI
Malaysia
Malta
Mauritius
Memphis
Mexico
Miami
Michigan
Minneapolis/St. Paul
Missouri
Moldova
Montenegro
Montreal
Morocco
Nashville
Nebraska
Netherlands
New Orleans
New Jersey
New York
New Zealand
North Carolina
Norway
Orange County, CA
Oregon
Pakistan
Palestine
Panama
Paraguay
Paris
Peru
Philadelphia
Phoenix
Philippines
Pittsburgh
Poland
Providence
Puerto Rico
Richmond
Reno
Romania
Russian Federation
San Francisco
Saudi Arabia
Scotland
Seattle
Senegal
Serbia
Singapore
Slovakia
Slovenia
South Carolina
Spain
Sweden
Switzerland
Taiwan
Thailand
Tokyo
Toronto
Tucson
Tunisia
Turkey
Ukraine
United Arab Emirates
Uganda
Uruguay
U.S. Virgin Islands
Venezuela
Washington, D.C.
Vietnam
Virginia
West Virginia

The Leading Edge Alliance is an international network of independently-owned accounting and consulting firms. Membership in The LEA gives us access to the resources of a multibillion dollar global professional services organization that provides technical resources, industry specialization, professional training and education, and peer-to-peer networking opportunities—nationally and globally, around the corner and around the world.

Our affiliation with The LEA enables us to expand our capabilities and provide a greater depth and breadth of advice and services to our clients. The bottom line? Our clients benefit from the size and scope of a large multinational firm with the high-touch, high-quality service of a local firm.

Leading Edge Alliance Fast Facts

- 190 leading accounting and consulting firms
- 102 countries
- 586 offices worldwide
- 2,056 partners
- 16,640 professional staff
- $2.9 billion in total revenues

100 WITMER ROAD, STE. 350
HORSHAM, PA 19044

ADDRESS SERVICE REQUESTED