Don't skate on thin ice with your clients

THE MORT EXCHANGE

By Mort Shapiro

In recent years clients' needs have become increasingly varied and sophisticated, particularly so in the areas of wealth accumulation, management and preservation.

Satisfying these needs has become increasingly complex in today's taxation and regulatory infrastructure. At the same time, clients have become more knowledgeable and aware, and increasingly tend to focus on maximizing their economic wellbeing by managing their financial affairs as effectively as possible.

It's important for public accountants to understand that if a client has a need, they'll find a way to satisfy that need. The areas of wealth accumulation, management and preservation are no exception to this rule. Although it may seem logical to many clients that their accountant would address these needs, such is not always the case. And unfortunately, when accountants do address these needs, they often do so with a deficiency of knowledge and expertise, which feeds the following 'thin ice' factor.

It's well recognized that today's public accountants practice in a litigious environment. Risk management is a mantra in the business world. To render advice without sufficient expertise or knowledge is akin to skating on thin ice. Not only does it create a real vulnerability from a litigation viewpoint, but it also exposes the practitioners to a possible breach of their professional rules by not sustaining their competence in those areas on which a client relies on them due to their professional status.

The reality is that whether or not they realize it, most public accountants are constantly practising in the areas of wealth accumulation, management and preservation and are often on thin ice when they do so.

It's because of these concerns that in this issue I join with my fellow columnist Peter Merrick to address a common thin ice scenario, which I encounter in my work in the world of public practice.

The profit distribution trap

In the all too common annual 'How shall we distribute / allocate this year's corporate net income?' meeting, practitioners tend to focus on traditional salary / bonus / dividend mixes which are based on the integration of personal and corporate tax rates and are designed to minimize current tax burdens and maximize the availability of disposable after-tax income in the present. However this traditional practice often requires new levels of knowledge and expertise in order to keep the practitioner from giving inappropriate advice.

For many clients, traditional strategies are often recommended without an appropriate work-up of a client's goals, needs and wishes (for the short, medium and long term). Even if this has been done at some previous date, circumstances may have altered a client's strategic goals.

Every profit distribution strategy has within it an implicit strategic plan. The thin ice develops when the implicit plan is not known to or appreciated by the client, who, with choices available, may have chosen to achieve some alternative goal, need or wish which might not necessarily have minimized current tax burdens and maximized the availability of disposable after tax income in the present.

The accountant's dilemma may be rooted in any or all of the following factors:

The client's current goals, needs and wishes (for the short, medium and long term) may not be known to the accountant, who then uses conventional planning strategies (i.e. maximizing tax paid disposable income when much of it ends up being redundant cash, but outside the client's corporation) which may not be well aligned with the client's goals.

The accountant may not be aware of strategies and techniques that are available to achieve alternative goals (i.e. the broad range of insurance products, deferred compensation plans and other such vehicles).

The accountant may not have the skills needed to guide the client through an intensive inward-looking process to develop a personal strategic financial plan (i.e. to identify and evaluate quality of life and life cycle events which must be addressed and reduced to very practical financial terms, and then explored at an emotional and psychological level).

The client may not be prepared to pay the accountant to explore his personal financial goals, needs and wishes (i.e. 'just tell me how to do it').

The accountant's vulnerability is rooted in the eventuality that a client may discover, after the fact, that they had choices as to how they could have managed their wealth differently, choices you as their accountant did not present to them. It's possible that even had alternatives been presented to the client, they would have chosen the path recommended by you as their accountant. But they or their heirs or legal representatives will be tempted to attack you for, at the very least, not having informed them of their alternatives (i.e. you took away their opportunity to make a choice).

I've asked Peter Merrick to address this example of the annual profit distribution strategy, and comment on the traps into which accountants all too easily fall. After familiarizing yourself with his cautionary words, I invite you to consider using the following self assessing checklist (this can be applied to an individual accountant or to a firm as a whole):

Do I realize what goals and objectives are implicit in the financial recommendations that I make to my clients? (i.e. what is being primarily achieved by my recommended strategy?)

Do I lead my clients through the process of developing goals and objectives for a financial strategic plan?

If yes:

Do I have the appropriate skills to do so? (i.e. interview skills, counseling, mediation if dealing with a family).

Do I have appropriate expertise and knowledge to appreciate what alternative strategies are available to achieve a broad range of goals and objectives? (i.e. the latest developments in legal and tax regulations, new and emerging financial products)

If no:

Do I communicate in writing to my client the range of goals that my recommendations do and do not achieve?

Do I have the client confirm in writing that I have recommended that they undertake the process of developing goals and objectives for a financial strategic plan, or that I have made such a recommendation and they have rejected it?

Whatever my responses were to the foregoing self-assessing questions, do I do these things on a regular basis so as to be satisfied that the information with which I am working is current? (i.e. the birth of a child, the illness of an aging parent, the development of a medical crisis or disability, etc.)

The opportunities for delivering real value to clients are there for the taking, as are the traps for delivering poor, incomplete or (as your client might argue) incompetent service. These opportunities flow from real needs which real clients have. To ignore them is to ignore the reality of the world in which you practice.

Be mindful of the fact that any attacks on your performance in this arena will generally come from persons of wealth. And they usually have the financial wherewithal to be serious attackers.

Readers should consider whether any of the strategies outlined by Peter Merrick would have been appropriate for one or more clients, either to adopt or at the very least to consider. If there are such scenarios and if they were not adequately considered, then you may have been (unknowingly) been practising on thin ice.

Mort Shapiro, CA, CMC and Peter Merrick, BA, FMA, CFP, FCSI address these areas together through their newly formed group Rockhaven Financial. Mort can be reached at 905-513-3736 or *mshapiro@shapiro-inc.ca.*

Accountants must readily embrace the big picture

MERRICK WEALTH

By Peter Merrick

In this month's column Mort Shapiro has posed several thought-provoking questions. He's asked me to address his scenario from the perspective of a Certified Financial Planner (CFP), in order to provide public accountants with some fresh insight.

I find it useful to keep in mind that in this developing era of convergence, most client financial problems are multi-dimensional. Efficient solutions tend to reach beyond the scope of the traditional public accountant's skill set.

Most clients' issues, be they strategic business planning, estate planning, succession planning, charitable giving, investments or insurance issues are as significant to the client as their tax issues. In order to successfully service their clients' needs, public accountants must ensure that they are capable of considering this broad range of concerns.

Shapiro has asked me to examine the common profit distribution trap from the perspective of this broader landscape. This trap usually arises during the annual review meeting between the public accountant and his or her client. The traditional question inevitably arises: 'How shall we distribute this year's net corporate income?'

Many public accountants fall into the trap of recommending a standalone salary/ bonus/dividend mix without considering the alternatives. This single-dimension strategy is built on two underlying assumptions:

- No obvious tax planning opportunities exist for corporately held investments funded from undrawn net income, so there tends to be a reluctance to leave funds in the corporation.
- The client is often presumed to wish to maximize the after-tax dollars in their hands today.

The problem with the latter assumption is that the accountant will likely have assumed this to be the client's goal without having explored its validity. In fact, the clients' goals may not be tax-driven at all. The accountant's exposure, which flows from the traditional assumption, is rooted in today's common client expectation that their accountant is capable of providing overall advice on the client's long-term financial welfare, and is a knowledgeable and capable strategic thinker.

Shapiro has identified the annual net profit distribution meeting as a 'thin ice' scenario. He speculates that a problem could arise if the client subsequently learns that they had other options (other than the salary/ bonus/ dividend mix recommendation made by the accountant) that would have better suited their needs by yielding greater overall benefits for the client, and better supporting the client's goals in both the short and long term.

Opportunities often exist whereby corporate funds created from undrawn net income can compound tax free within the company or tailed executive benefit plans.

These opportunities are often viable and complementary to the traditional salary/ bonus/ dividend mix strategy.

These alternatives are available through financial solutions which may take the form of: Corporate class money managed products, corporate interest rate swaps, retirement compensation arrangements, individual pension plans, corporately owned universal life insurance, and health and welfare trusts. (This is not an exhaustive list of the alternatives.)

Corporate class money management products

This is a strategy whereby a third-party money management company invests the client's corporate funds. This investment structure allows a business to invest its funds in tax-effective investment type accounts that allow for the switching between fund classes of shares within the same fund corporation, without triggering capital gains for the client corporation. As with many vehicles, there are limitations: assets will attract tax if they are withdrawn from the third-party money management company.

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Job candidates more demanding

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Bruce Brooks, national human resources partner with the mid-market firm Collins Barrow, said the accountant shortage can be summed up as a case of supply and demand. "Twelve per cent of chief financial officers in Canada planned to add full-time accounting staff in the first quarter of 2006, according to a survey by financial staffing firm Robert Half International," he said. In addition, "as one component of the demand issue, the new (government reporting) requirements created a capacity issue in all firms, regardless of size."

Still, according to one of the Big Four accounting firms, increased regulatory requirements have seemed to attract rather than repel up-and-coming young talent. "Companies, regulators, and participants in the financial markets all concluded that there needed to be changes to the accounting and reporting process. So not only accounting firms but also companies, securities regulators, and others have all needed more qualified accountants," said Karen Wensley, human resources director with Ernst & Young.

"Since accounting and auditing is now the number one preferred major for university students in Canada, it's clear that there is no deterrent to potential employees from entering the accounting profession."

In terms of how the business sector is reacting to the accountant shortage, it seems there are a range of interpretations and a myriad of differing perspectives. Where Wensley noted that "a professional firm's business is the expertise of its people, so a shortage of those people is obviously bad for business," others have a different view.

"While (staff shortages) can drive up costs or decrease production, they can also lead to efficiency innovations and new processes that allow fewer people to do more with less," said Leader.

Brooks' viewpoint lies somewhere between. "Change has positive and negative consequences," he said. The staff shortage "has had impact, good and bad, such as educating clients on fee increases. From their perspective, we are offering the same value in financial statements but our cost of business has risen so dramatically that there is a push back. That being said, there is a push down as well, where clients of firms larger than ours are dissatisfied with the fees-and-value equation."

And it's how organizations deal with the positive and negative aspects that dictate where circumstances will lead in the future. But one thing is clear: As young professionals choose accounting as a career pathway, their negotiating power to secure a choice position can give them the upper hand.

"Accounting firms have less power, in that fewer candidates have more options and demands," Brooks noted. "For non-partner professionals on the other side of the equation, obviously they have seen an incredible improvement in their negotiating position."

WENSLEY

And the ICAO agrees. "Graduating CAs today have a wider range of employment options than ever before in public practice, industry, academe, not-for-profits, and the public sector," Leader said. "This has led to a steady increase in the salaries CAs can command." He noted that the median salary for first-year CAs in the Greater Toronto Area is $72,000 per year, with 63 per cent of Ontario's CAs earning over $100,000 annually.

While the average CA earns over $168,000 a year, the median salary for a Canadian CA working in the industry outside of North America is $178,000 annually. Although salaries and a host of other perks may be effective to recruit new blood, retention becomes another important factor.

"Retention is always a challenge in a marketplace where people have lots of choices," said Wensley. "We are very pleased that our retention rates have been increasing over the past several years." She added that targeting new graduates and seasoned professionals are both part of Ernst & Young's human resource strategy. "We target experienced hires as well as new graduates. One of our key strategies is to go after our alumni—people who worked at Ernst & Young in the past, went out to try a job in industry, and now are interested in returning," she said. "We have also been targeting qualified accountants from other countries. We also offer part-time roles to people who left the workforce."

Collins Barrow is using similar strategies to recruit and retain accountants, and acknowledges the usefulness of focusing on remuneration and other special considerations for new employees. "There are a number of initiatives we pursue such as increasing our presence on campus, and engaging prospective employees on a deeper level to understand the unique needs and wants they have," Brooks said. "We do all the regular things too, like flexible schedules, benefit packages, specialized training and accreditation, and we have a number of creative tactics at the local office level that attract people for a wide range of reasons."

At the association level, Leader said the ICAO has taken numerous steps to attract students. These include providing accreditation to Ontario universities, and a new ad campaign, that focuses on marketing accounting to students. "Certainly the competition for top talent has increased," Leader said. And "it will likely increase in the future."

Servicing clients key to avoiding problems

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Corporate interest rate swaps

This is a strategy whereby the client purchases units in a fund held by a third-party money management firm. The money market returns will be taxed as capital gains only on sale.

Funds invested in such corporate interest rate swaps allow the business to have access to this money in a secure way while at the same time delaying the taxation of the returns on such monies and leveraging the deferred tax dollars.

Owners who are employed by an incorporated business should consider creating a 'supersized RRSP' in the form of an Individual Pension Plan (IPP) or a Retirement Compensation Arrangement (RCA).

Contributions to these two vehicles for older clients will exceed the maximum allowable RRSP limits, are fully deductible by the sponsoring company and are a non-taxable benefit for the individual. Increases in the total value of the assets held in the vehicle are tax-deferred until withdrawn.

Both IPPs and RCAs offer the potential for significant amounts of additional tax-deferred income to be set aside for retirement.

Corporately owned universal life insurance

Universal life insurance (UL) provides tax-sheltered growth within a policy. A corporately owned life insurance contract can tax-shelter large portions of a company's retained earnings in the cash value potion of the UL policy provided that the premiums are not deducted. The business owner can then access these funds personally, or for use in the business during his or her lifetime by collateralizing the policy through loans from a bank.

For example, the individual might borrow funds annually in order to increase his or her retirement cash flow. Appropriate documentation and guarantee fees must be in place in order to avoid a personal (deemed) benefit.

Any related bank loan would be repaid automatically at the death of the insured business owner from a portion of the policy proceeds. At the same time, a credit to the corporate capital dividend account would be created equal to the full policy proceeds.

Health spending accounts

A health spending account (HSA) is a bank account created by the corporation and whose deposits are available exclusively for healthcare expenses. By having an HSA, business owners are able to convert healthcare expenses into100 per cent business deductions equal to the deposits into the HSA in the year.

Payments of these healthcare expenses are treated as a non-taxable benefit to the business owner. The business owner determines the contribution amount each year and also determines how to spend the benefit dollars. Unlike traditional medical and dental plans, if the deposits are not spent in the current year, then the funds remain in the account, available for future use. In essence, if you don't use it, you don't lose it.

The bottom line

As Shapiro has suggested, if a client's needs are not being satisfied by their accountant, then there is a very real possibility the client will have those needs satisfied by someone else and may attack their accountant if a strategic opportunity has been lost.

Today's public accountant should at least be aware of options such as those noted above and should be prepared to bring these alternatives to their clients' attention in the event that they would address client needs beyond the traditional salary/ bonus/ dividend mix recommendation. Such service is the best strategy for avoiding thin ice.

In order to ensure that you are satisfying your clients' needs, consider asking them the following question: *What do you want to achieve this year with your money?*

Make sure that your client understands your question. This question should elicit whether the client's goals for their money in the current year are for consumption, retirement or estate purposes.

Each type of goal requires a different set of tailored solutions, which may or may not include the traditional salary/ bonus/ dividend mix recommendation.

This question also implies that the practitioner should ask the same question each year because as every public accountant knows, life changes and so do a client's needs and goals from year to year.

If a public accountant fails to identify and address these new changes in the goals and direction of a client's life, then that practitioner risks skating on thin ice.

Peter Merrick, BA, FMA, CFP, FCSI and Mort Shapiro, CA, CMC address these areas together through their newly formed Rockhaven Financial. Peter can be reached at 416-854-1776 or peter@merrickwealth.com

Bragging rights free

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only access their personal information, but managers are granted access to the files for their whole department. It certainly saves some time and aggravation for the HR department.

An important point must be made here. All seven modules are developed internally by Avanti Software Inc. There is no outsourcing. The result is slick and seamless integration, and each ties in and utilizes data from another.

Avanti runs on SQL 2005 and is a Microsoft certified partner, and Epicor registered partner. It integrates with Great Plains, Accpac Advantage, Solomon, Sun Systems (Systems Union), and the aforementioned Epicor. What I mean by integrate is that the user can validate GL accounts and export (GL) entries into their accounting program.

Avanti is a seriously powerful system and I am only able to scratch the surface in this article. I can show you what one of their pay statements looks like though. Plug in *www.avanti.ca/payadvice* and see a typical pay statement for an employee on direct deposit. From there you can surf their entire site too.

Maestro, cue the Baroque String Quartet please. Thusly and in conclusion, should one find oneself in dire need of a powerful payroll and human resources solution with poise, depth, fantastic flexibility and remarkable refinement, Avanti is worth a look. Bragging rights are included at no extra charge.

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