



Current M&D Developments: Elevate **Your** Business

November 10, 2022 | Green Bay, WI

We'll get you there.



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Learning Objectives

- At the end of this session, you will be able to:
 - Recognize how lease standards may affect your business
 - Identify tax law changes that could reveal new opportunities for your business and you
 - Identify how current events might impact your M&D business strategy
 - Discuss economic updates regarding interest rates, inflation, and war
 - Recognize how to modernize your business operations





Manufacturing and Distribution Industry Update

Jennifer Clement, CLA

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Balancing Act

**Cash Flow
Working Capital**



Being Prepared

Supply Chain Landscape



Pricing



Inventory



China Economy



Zero Covid



Risk



Material Pricing

	Dec 2019	June 2020	Dec 2020	Feb 2021	May 2021	Aug 2021	Mar 2022	Aug 2022	Oct 2022
Aluminum (LME)	\$1,800	+ 5%	+ 10%	+ 19%	+ 37%	+ 45%	+ 128%	+ 35%	-3%
Steel (HC)	\$543	+ 1%	+ 28%	+ 34%	+ 91%	+ 71%	+ 55%	+ 8%	+4%
Stainless Steel (304)	\$1,930	+ 5%	+ 7%	+ 17%	+ 32%	+ 55%	+ 64%	+ 17%	+20%
Plastics (ABS)	\$1,879	- 1%	+ 41%	+ 45%	+ 68%	+ 63%	+ 23%	- 6%	-3%
Copper (LME)	\$6,155	+ 2%	+ 26%	+ 30%	+ 72%	+ 53%	+ 74%	+ 31%	+23%

Base

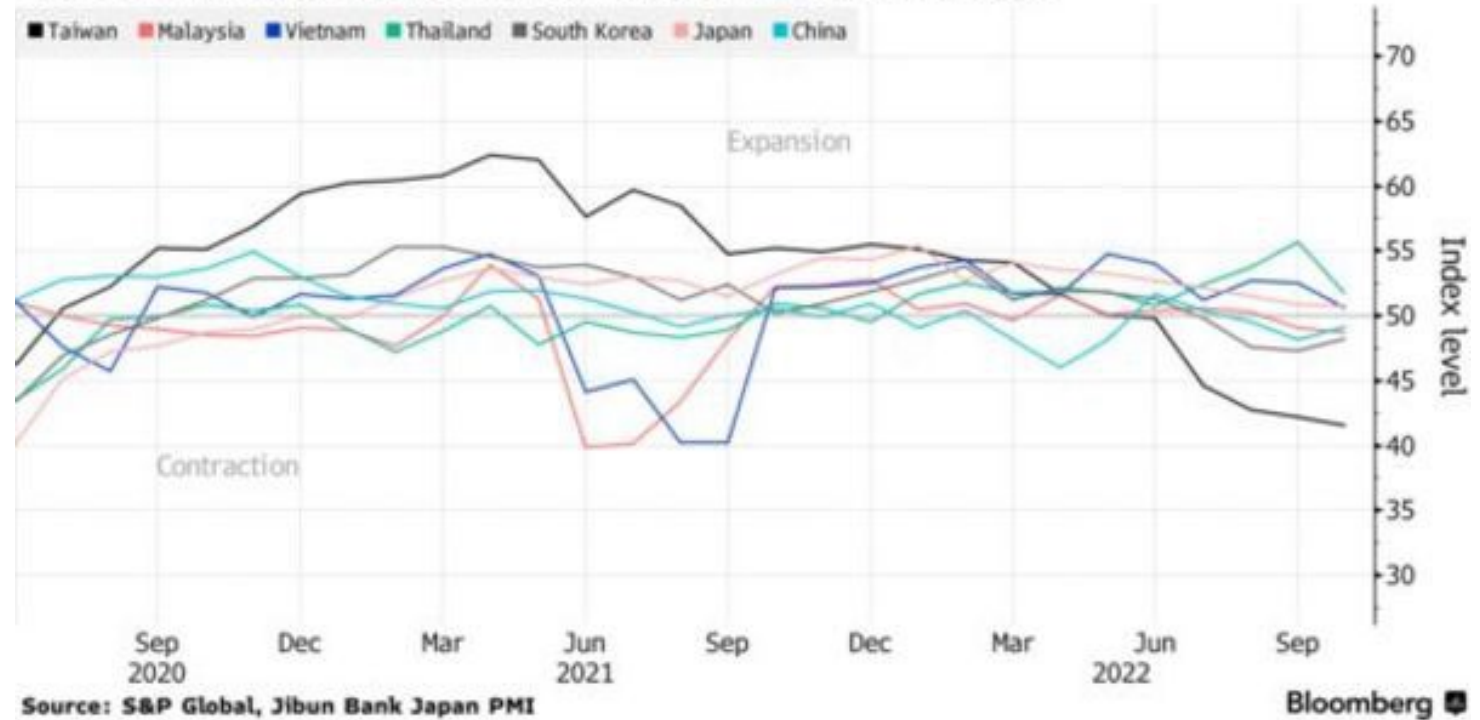
Peak

Source: Complete Manufacturing and Distribution



Demand Fades

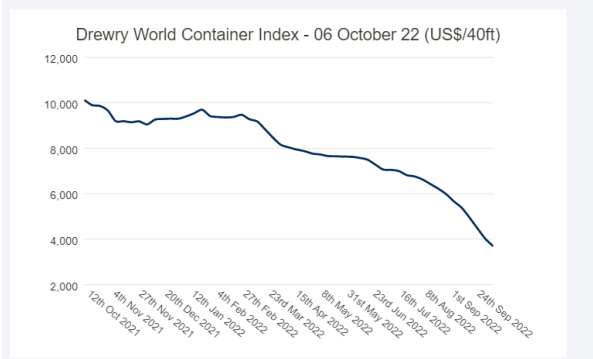
PMI readings show slump in Asian factories as demand drops



Pricing: Container Rates

World Container Index - 06 Oct

Drewry's composite World Container Index decreased by 8% to \$3,688.75 per 40ft container this week.



These are container freight rates for October, 2022 according to the [Freightos Baltic Index](#):

FBX Lane	Global	Asia – US West Coast	Asia – US East Coast	Asia – North Europe	North Europe – US East Coast
This Week	\$4,056	\$2,978	\$6,952	\$7,046	\$7,531
Last Week	-3%	-8%	-5%	-3%	5%
Last Year*	-59%	-82%	-63%	-52%	8%

* Compared to the corresponding week in 2021

[Shipping Delays & Freight Cost Increases 2022 | Freightos](#)

Returning to 2018 levels?

[Drewry - Service Expertise - World Container Index - 04 Aug](#)



Pricing: Currency




30D

60D


90D

- China exports to USA are cheaper
- 7.35 by end of 2022
- 7.5 within 2023

 **USD** US Dollar

1


USD EUR GBP BTC

 **CNY** Chinese Yuan R...


7.24157


CNY USD GBP ETH

Date

< 24 October 2022 > 

Preview interbank rate

+/- 0% 





Pricing: Tariffs

The U.S.-China Tariffs

Tariffs, by percentage rate, imposed by the U.S. and China on each other since March 2018

□ Imposed by the U.S. on China ■ Imposed by China on the U.S.

March/April 2018

□ \$40B
■ \$3B

Steel and aluminum products from most countries (10% aluminum, 25% steel)
Wine, pork, nuts, steel pipes, recycled aluminum (15% to 25%)

July 2018

□ \$34B
■ \$34B

Aircraft parts, semiconductors, microscopes (25%)
Soybeans, wheat, electric vehicles, whiskey, seafood, cigars (25%)

Aug. 2018

□ \$16B
■ \$16B

Motorcycles, steam turbines, railway cars (25%)
Beef, poultry, fiber-optic cables, motorcycles (25%)

Sept. 2018

□ \$200B
■ \$60B

Fabric, modems, chemicals, furniture, seafood (10%, raised to 25% in May 2019)
Cosmetics, vodka, reptiles, wigs, diamonds, video games (5% to 10%, raised to 5% to 25% in May 2019)

Sept. 2019

□ \$110B
■ \$25B

Agricultural products, antiques, clothes, kitchenware, footwear (15%, dropping to 7.5% under an agreement announced Dec. 13 in which China promised a "corresponding" amount of tariff rollbacks)
Agricultural goods (5% to 10% on top of existing tariffs ranging up to 25%), crude oil (5%)

Sources: Office of the U.S. Trade Representative, Bloomberg
Note: Dec. 13 reference in Sept. 2019 box is for same year

As of
November,
2022...

Tariffs will be
continued.



Inventory

Risk

Increased inventory levels
now easing...



Actions

Moved from JIT (Just in Time) to JIC (Just in Case); transitioning back to JIT – OR NOT!

- Demand catching up with supply
- Easing supply shortages could eventually take some pressure off inflation

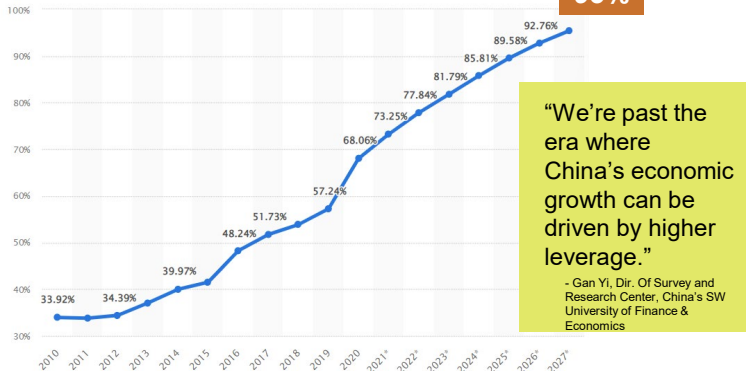
Economy

Bottom line:
Western companies betting on China for growth...trim forecasts?

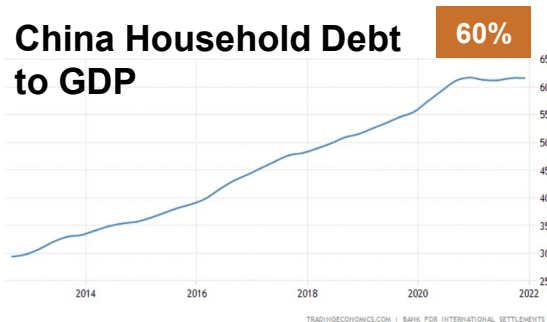
2022 China sales:

- ↓ 44% Starbucks
- ↓ 20% Nike

National Debt to GDP Ratio



China Household Debt to GDP



- Infrastructure
- Property
- Exports
- Household Consumption

**Lowering interest rates is not working...
because consumers are not spending.**

- China's household debt to GDP ratio up 60%.
- 50% of China's GDP is dependent on consumer spending.

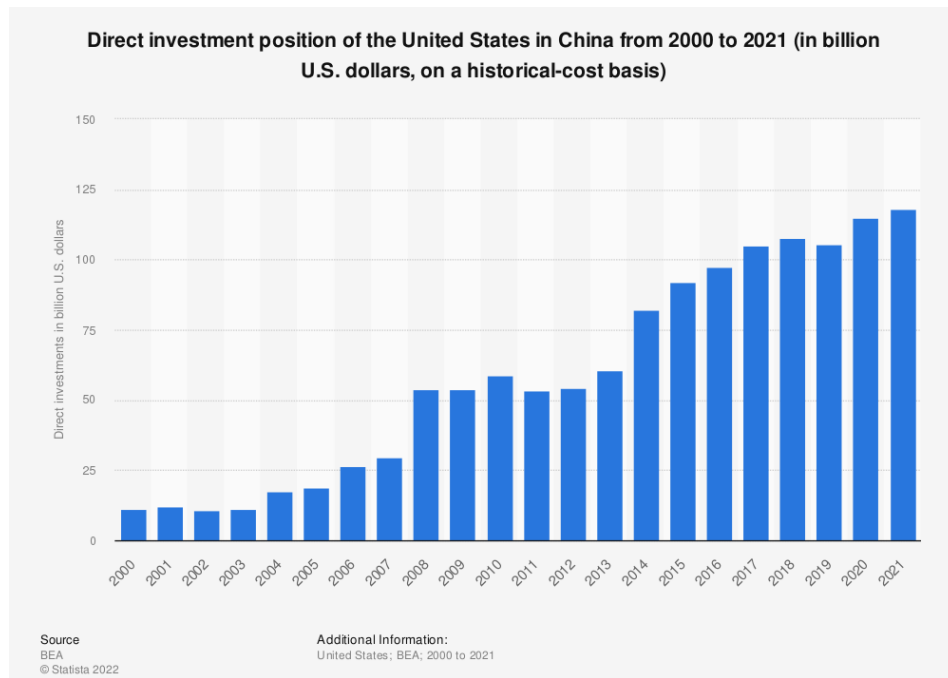
[Chinese Households' Pivot to Thriftiness Is Bad News for World Economy - Bloomberg](#)



China Economy: FDI into China

BEIJING — Foreign direct investment (FDI) into the Chinese mainland, in actual use, expanded 17.4 percent year-on-year to 723.31 billion yuan (\$112B) in the first half of 2022, the Ministry of Commerce said on July 29.

[China's FDI inflow up 17.4% in H1 \(www.gov.cn\)](http://www.gov.cn)



Hi-Tech Manufacturing

↑ 31%

Hi-Tech Services

↑ 34%

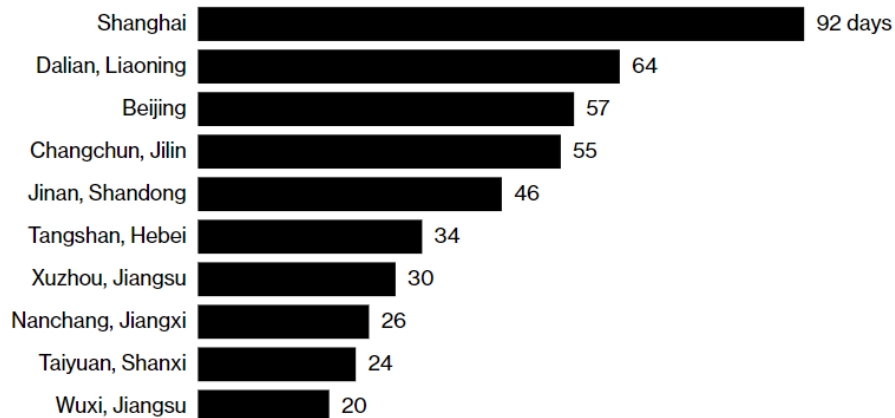


Zero Covid

Longest Lockdowns

Curbs have been imposed on a raft of key Chinese cities

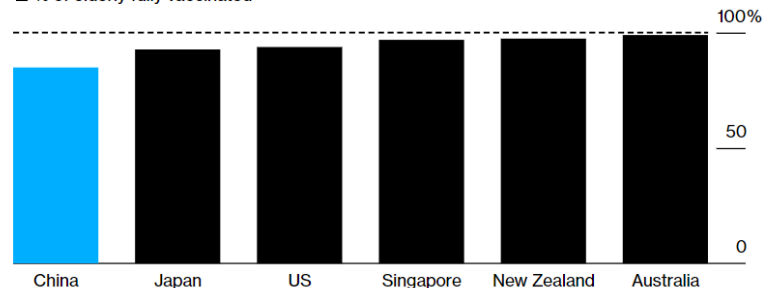
■ Accumulative days in full or partial lockdown since March 10, 2022



Vaccine Defense

China lags behind on immunizing older people against Covid

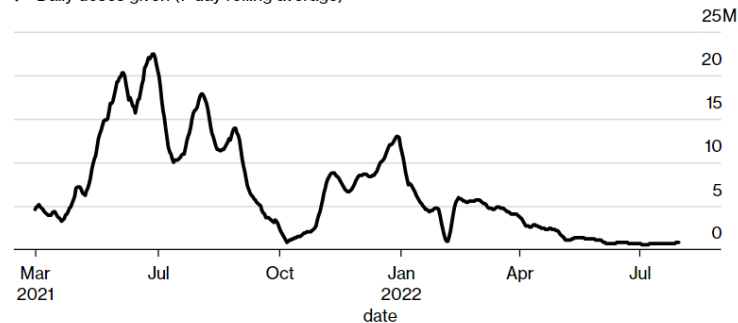
■ % of elderly fully vaccinated



Losing Steam

China's vaccine rollout has slowed to a trickle

／ Daily doses given (7-day rolling average)



Source: National Health Commission



Zero Covid: Travel

Passengers traveling to China must **get their nucleic acid test results from laboratories**, then **apply for health code** from the Chinese Embassy or Consulate General (based on the latest consular jurisdiction of nucleic acid test laboratories), travel before it expires and be prepared for checking by the airlines before boarding.

1. Foreign passengers can apply for health code at <https://hrhk.cs.mfa.gov.cn/H5/>.
2. Nucleic acid samples can be collected and tested at any legal laboratory institution with CLIA certification. Test reports should contain specific information such as name, passport number, date of birth, date of collection, date of report and the contact information of the laboratory. The Embassy will contact the issuing agency to verify the authenticity of all the submitted reports and certificates. If any of them cannot be verified, the health code will not be issued.
3. Test requirements before your departure:
 - A. **Within 48 hours before departure, take twice nucleic acid tests** with different test reagents at different laboratory. There must be an interval of over 24 hours between samplings. (e.g., If the flight departs on July 10, the first sampling time can be on July 8, and the second time can be on July 9).
4. The following documents are to be uploaded for health code application:
 - A. Nucleic acid test results, flight itinerary, passport, Chinese visa or resident permit.
 - B. If you have infection history / are a close contact / show symptoms, please upload supplementary documents according to the requirements below.
5. Passengers will receive a "green code" when all their test results are verified. Before boarding, passengers will be required to present "green code".
6. Passengers with infection history:
 - A. If you were diagnosed with COVID-19 or tested positive for nucleic acid, you are considered as having an **infection history**.
 - B. You can apply for a health code if you meet the following requirements:
 - **Take twice nucleic acid tests** with a sampling interval of over 24 hours in any laboratory in the U.S. and both tests return negative results.
 - Take a **self-quarantine for at least 2 weeks** and record your daily body temperature and health conditions after the second nucleic acid test. If you develop any symptoms such as fever, cough, diarrhea during the self-quarantine, take another nucleic acid test. If the result is negative, start a 2 weeks quarantine again. If the result is positive, you will need to wait until you recover and redo the whole process.
 - After completing the above procedures, follow this notice to perform **tests within 48 hours before boarding**. To apply for a health code, two additional nucleic acid test negative reports are required.
7. Close contacts/showing symptoms
 - A. Passengers who have had unprotected contact with confirmed, suspected or asymptomatic cases are considered as close contacts. Passengers with a positive antigen result are considered as close contacts as well.
 - B. Close contacts or passengers showing suspected symptoms are expected to self-quarantine for at least 5 days. If your health is not abnormal at all, follow this notice to perform tests within 48 hours before boarding.

It's complicated.



Geopolitical Business Risk

Four Scenarios

1. **“Competing while Cooperating” (10%):** While competing in many areas, China and the United States collaborate on investment, commerce and trade issues.
2. **Base Case (60%):** Economic ties remain intertwined, but political competition continues. Both sides recognize the risks of letting ties deteriorate too far but lack the incentive or political space to improve them.
3. **“Confrontation” (25%):** Deteriorating political relations spill over into other areas. Over time, China eventually provides Russia military support which could lead to secondary sanctions and tighter export controls.
4. **“Crisis” (5%):** A military incident over an issue such as Taiwan or the South China Sea leads to a dangerous confrontation.

Clouds on the Horizon

Outbound investment screening
Notification vs. approval

HFCAA
Chinese U.S. listed company removed from US exchanges

Taiwan Policy Act of 2022
Authorize \$4.5 billion over four years in Foreign Military Financing

Chinese support for Russian military action
Integrated deterrence

New 301 Investigation
Covering systemic issues not addressed by Phase 1



2022-23 Landscape in Europe

Economy

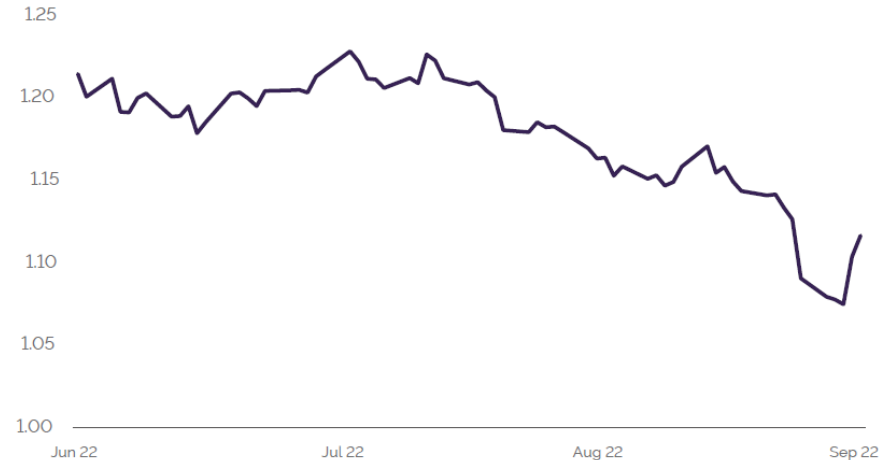
Challenges

- Slower growth
- Lower valuations
- Xrate volatility
- Higher inflation, interest rates

Impact for CLA Global Clients

Bargain investments?
Risk premium negates
lower valuation?

GBP/USD exchange rate (\$)



Source: Refinitiv DataStream/Evelyn Partners Investment Management LLP,
data as at 30 September 2022



2022-23 Landscape in Europe

Ukraine

Challenges

- UK energy caps for consumers, businesses
- Price caps leading to lower energy supply

Impact for CLA Global Clients

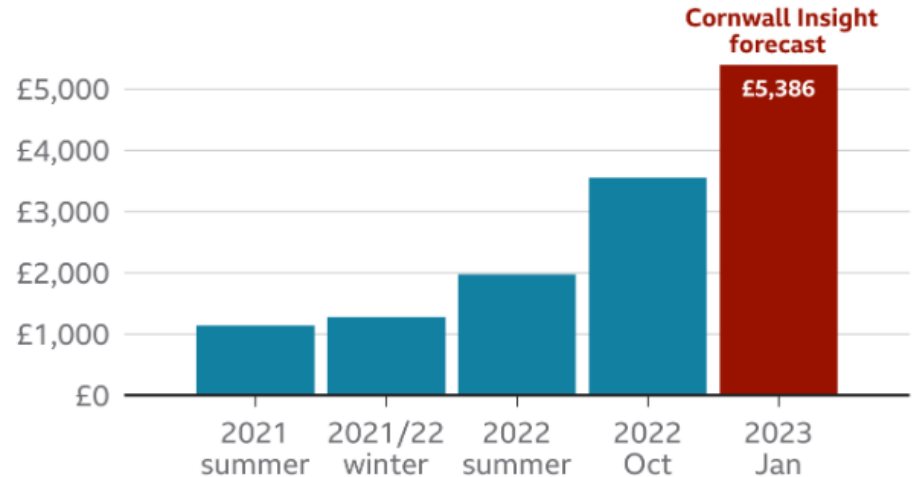
Energy intensive businesses will be difficult to forecast beyond 6 months.

Suppliers demanding deposits.

Cash flow impact.

Energy price cap forecast to rise to £5,386

Annual bill for a typical household on a price capped dual-fuel tariff paying by direct debit



Source: Ofgem/Cornwall Insight, 26 Aug

BBC



Takeaways



1. Volatility: Fact or Fiction?
2. Supply chain de-risking
3. Pricing is less a driver
4. Options for managing inventory
5. Balancing act...



We'll get you there.

Thank you!

Jennifer Clement

Client Relationship Leader

jennifer.clement@CLAconnect.com

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Short Break

CLA exists to
create opportunities —
for our clients, our people,
and our communities.



Wealth and Economic Update: Navigating Markets During Volatility

Chris Moss, CLA Wealth Advisors

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The Four Essential Elements of the CLA Promise



Driven by **Our Values**





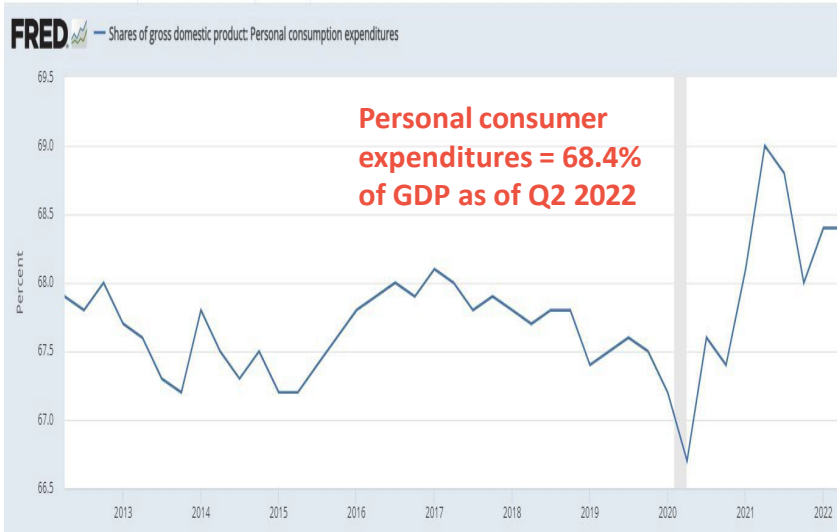
Economic Observations

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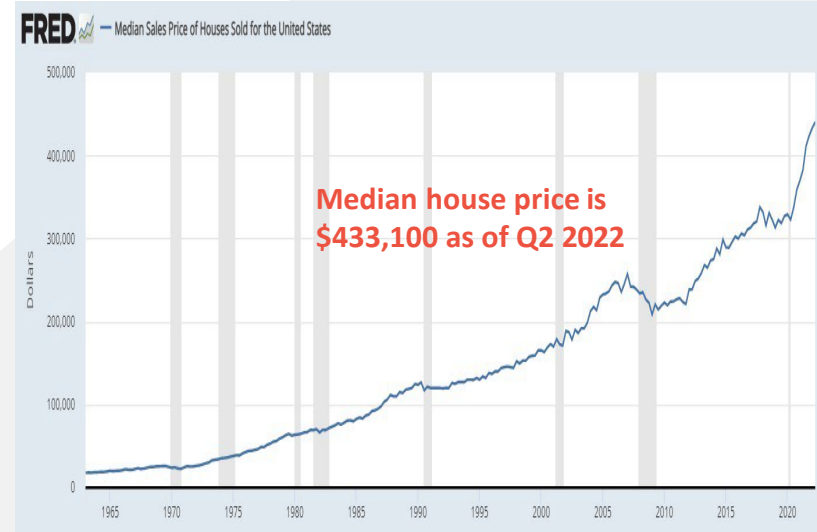
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Economic Data Shows the Reopening is Real



Source: St. Louis Fed

Consumer spending is robust

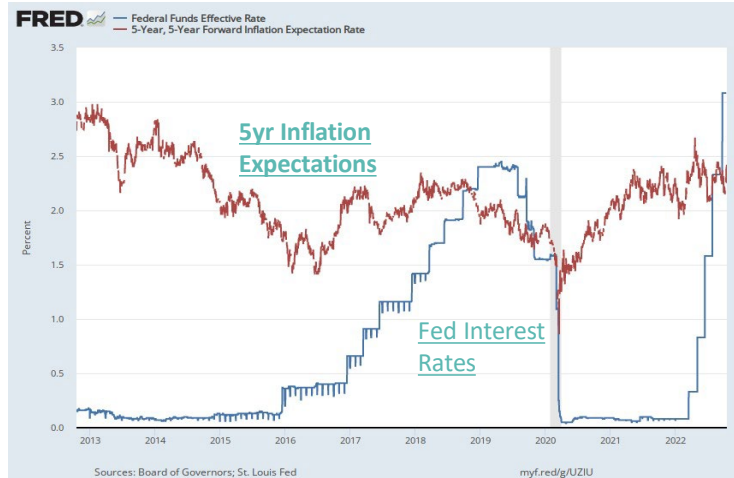


Source: St. Louis Fed

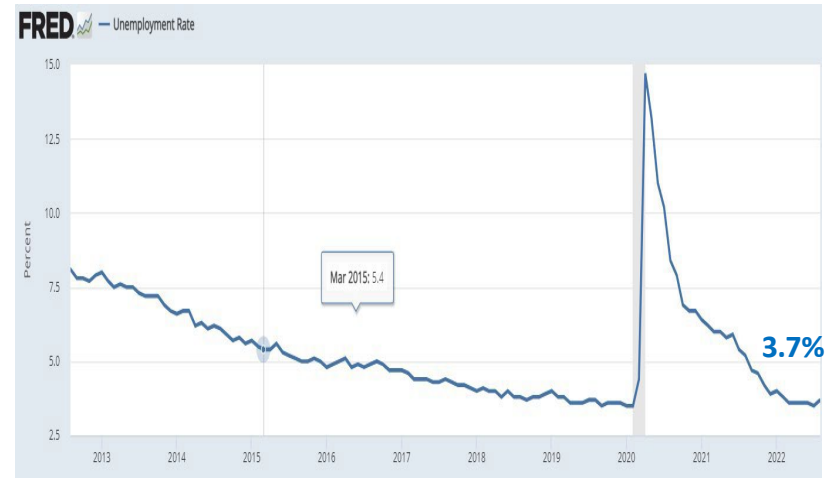
Housing prices hit new highs



Economic Data Shows the Reopening is Real



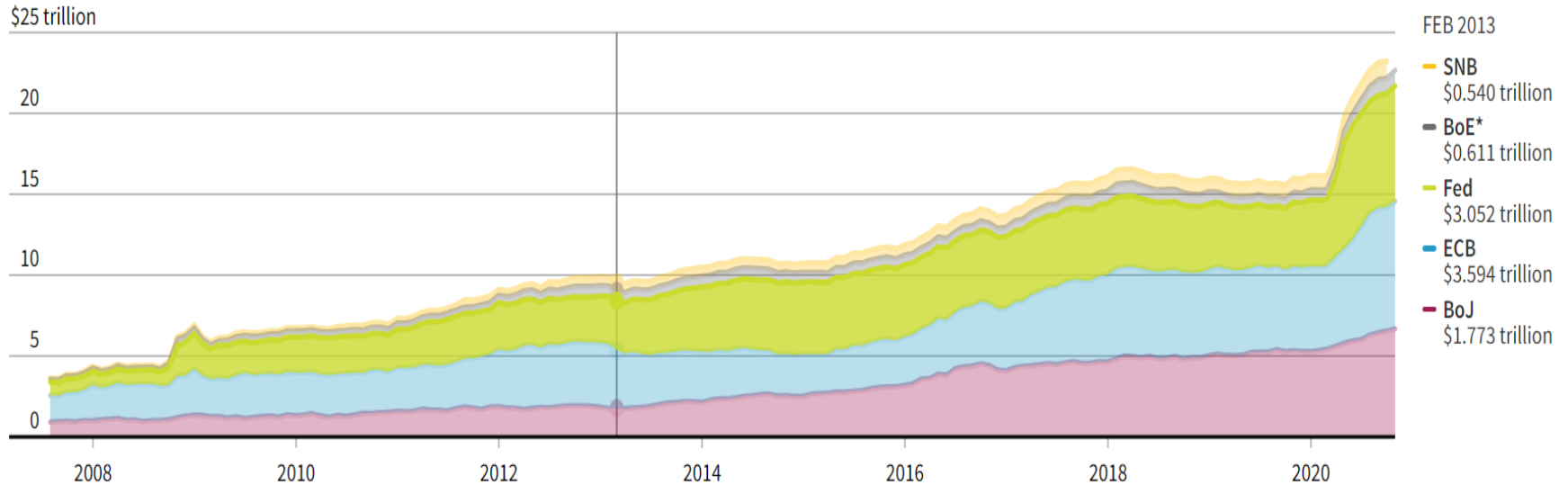
Source: St. Louis Fed



Higher inflation → Higher rates

Unemployment at pre-COVID levels

Global Central Bank Stimulus is a Tailwind



Central bank balance sheets

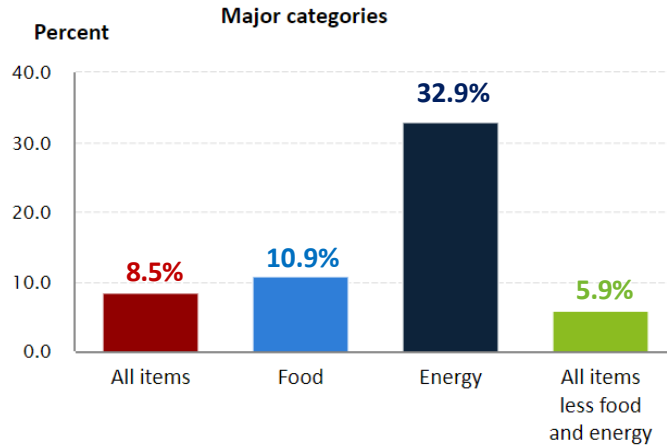
Assets for the European Central Bank, Bank of Japan, Federal Reserve, Swiss National Bank, and Bank of England

Source: Thomson Reuters



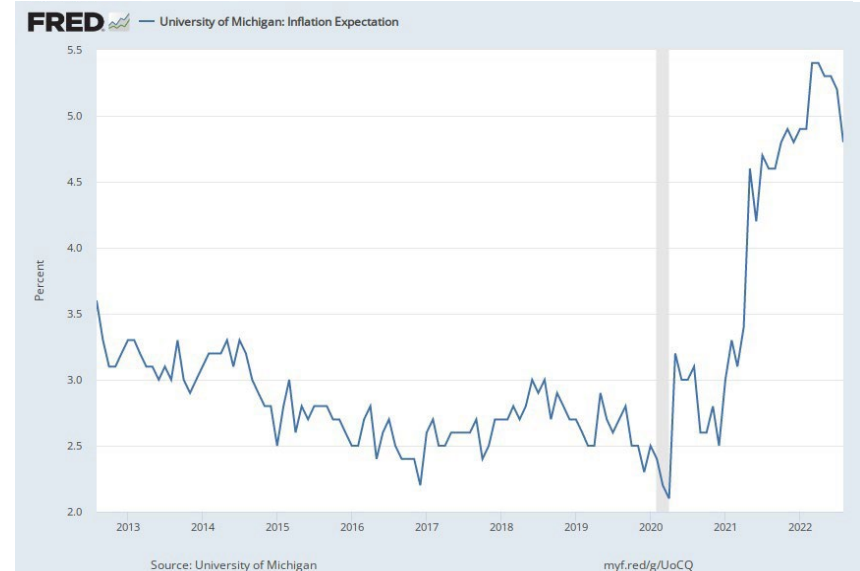
Inflation is Likely to Remain Front and Center

12-month percentage change, Consumer Price Index, selected categories, July 2022, not seasonally adjusted



Source: U.S. Bureau of Labor Statistics.

Higher prices driven by energy ...



Source: St. Louis Fed

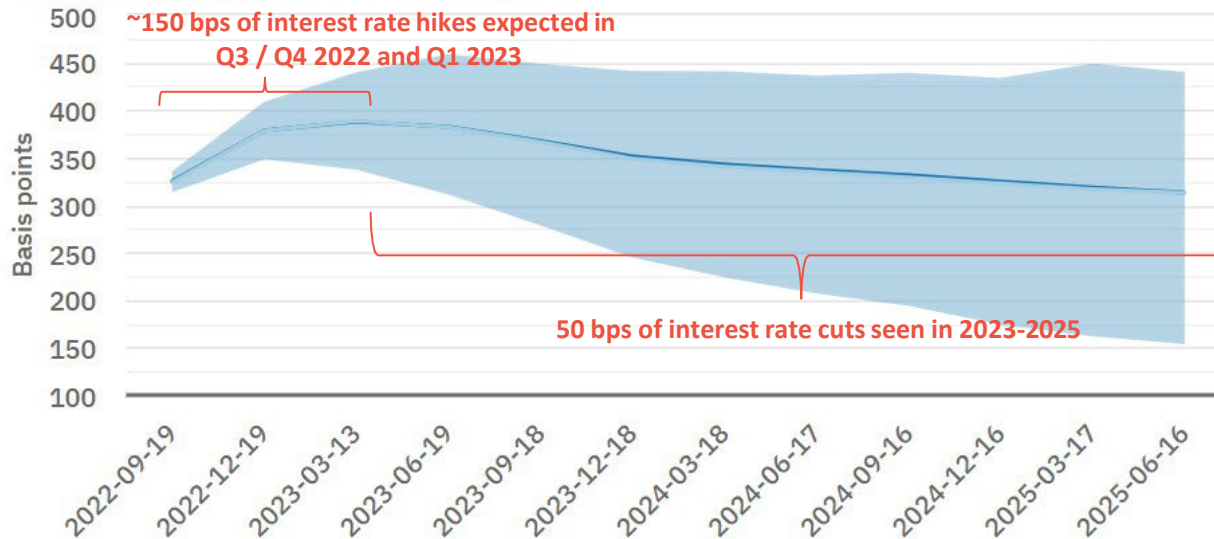
... Driving future inflation expectations



Expect Interest Rates Hikes in 2022 but Cuts starting in 2023

The Expected Future Path of the Three-Month Average Fed Funds Rate

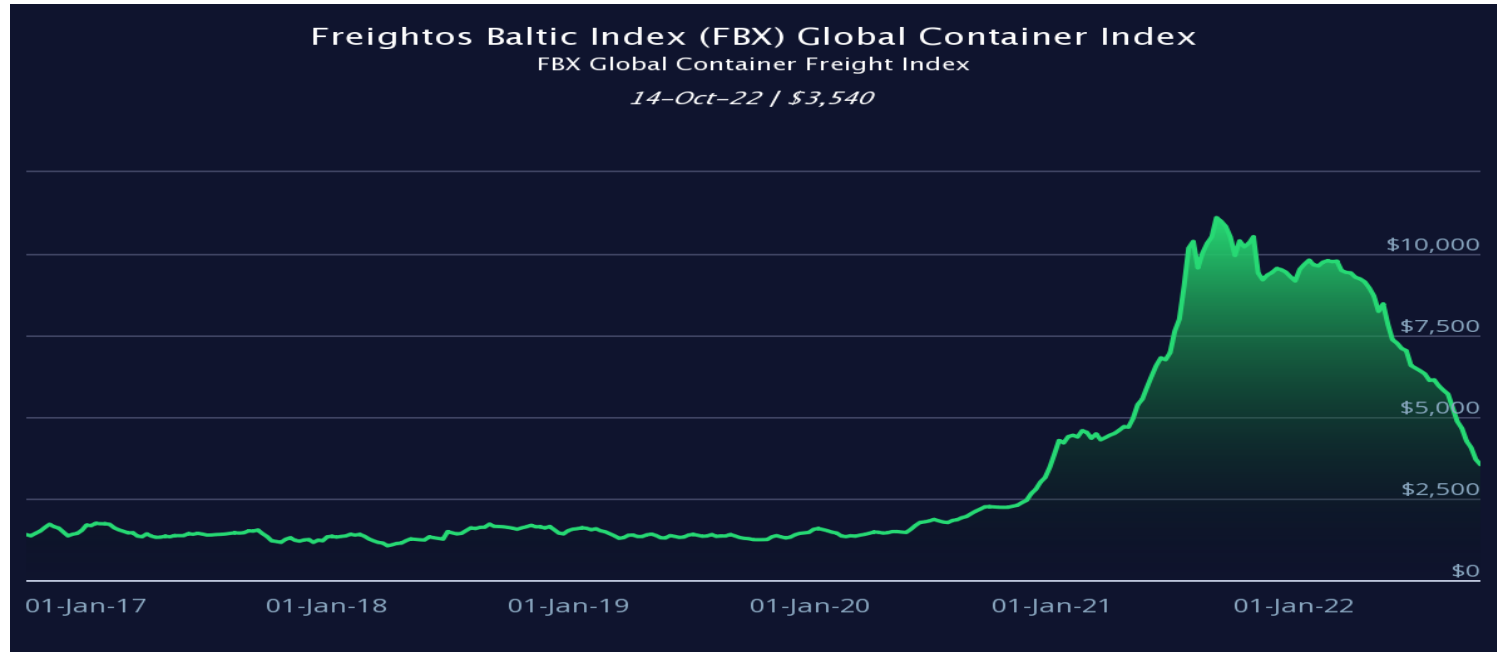
Current target range: 225 - 250 basis points



Source: Market Probability Tracker - Federal Reserve Bank of Atlanta (atlantafed.org)



Supply Chain Stress is Starting to Ease



Global shipping rates still elevated but off highs



Source: [Freight Rate Index / Freightos Baltic Container Index](#)

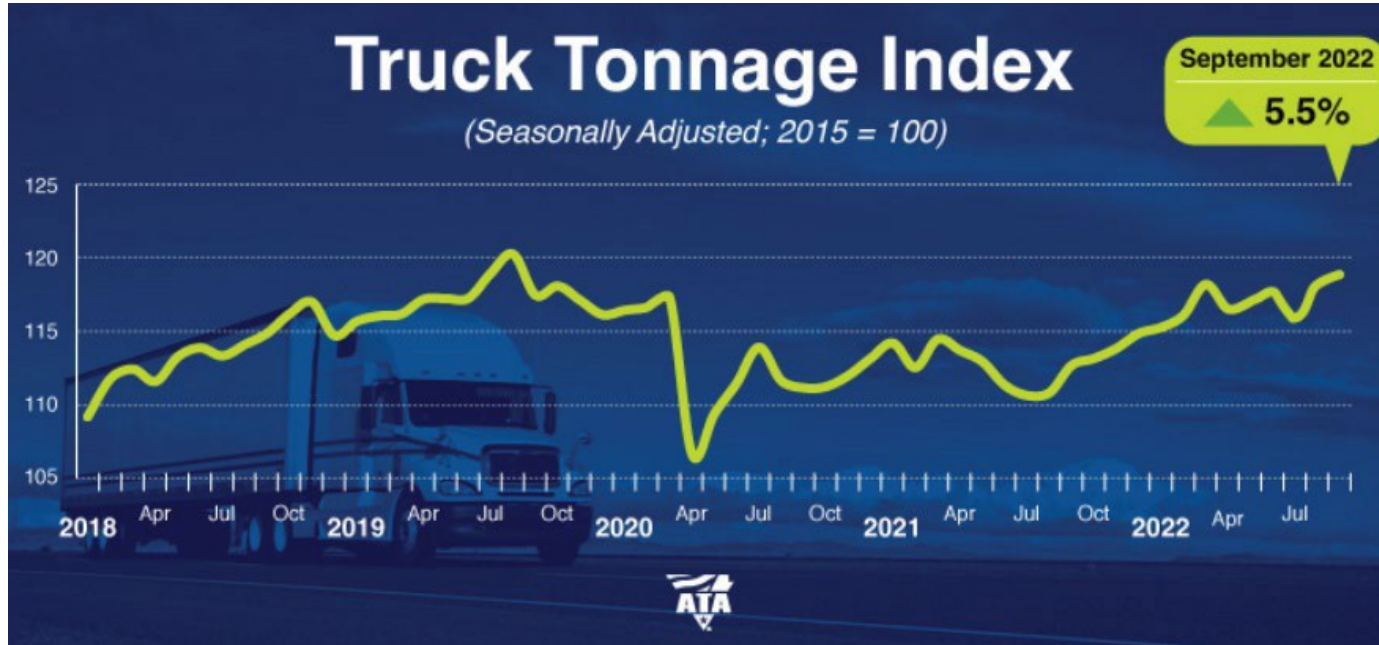
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Industry Insights: Pick-Up Seen in For-Hire Trucking Tonnage



[Source: American Trucking Association](#)



Market Observations

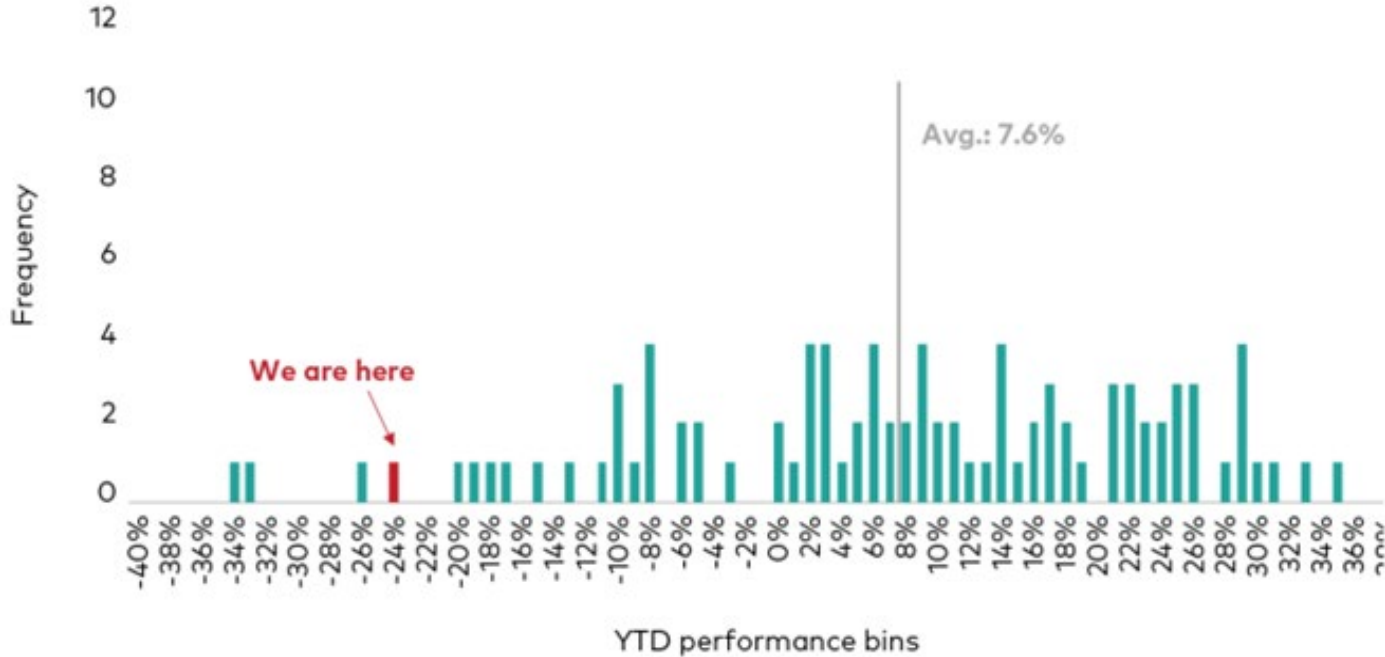
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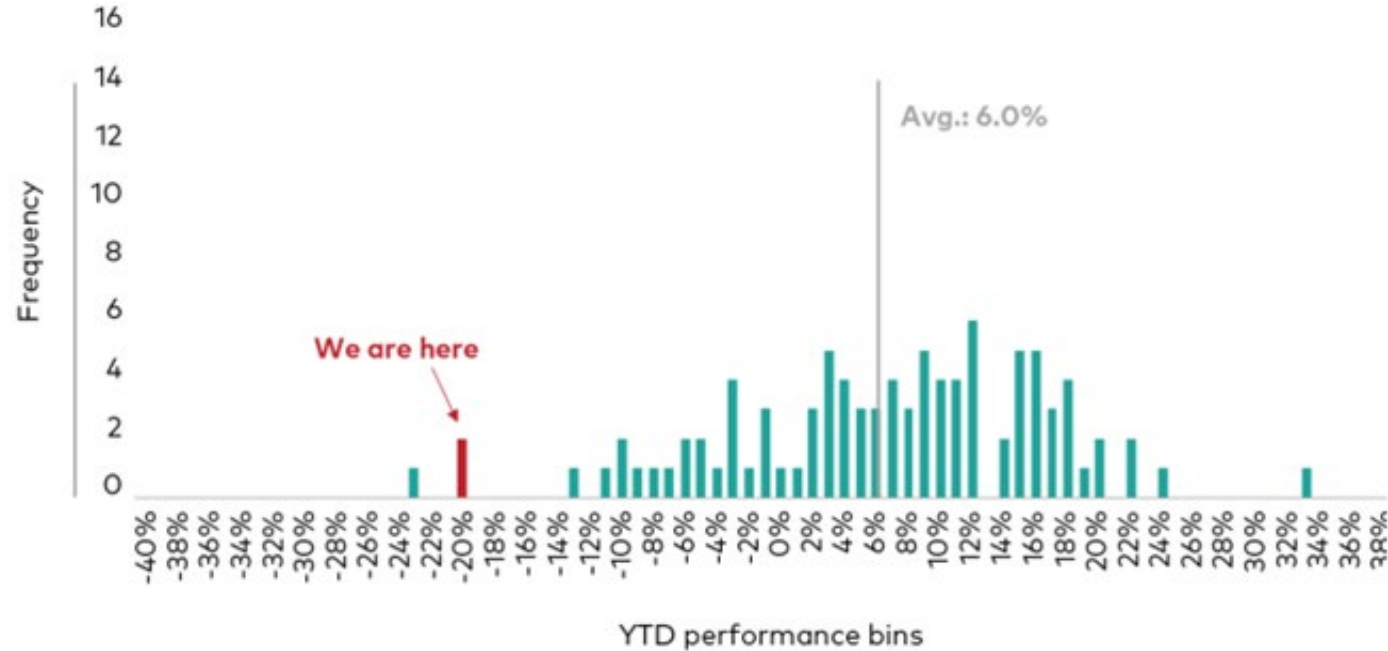
Market Volatility is Extreme

a.) Distribution of YTD stock performance (1928-2022)



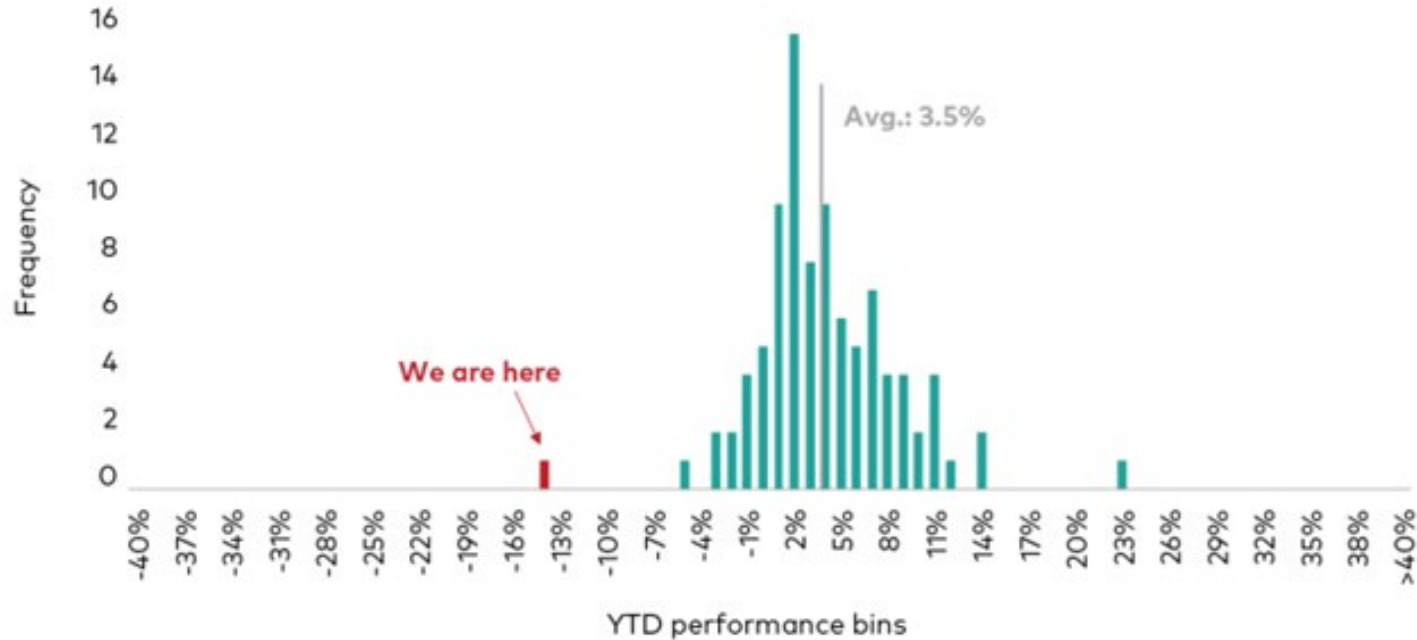
Market Volatility is Extreme

c.) Distribution of YTD 60-40 performance (1928-2022)



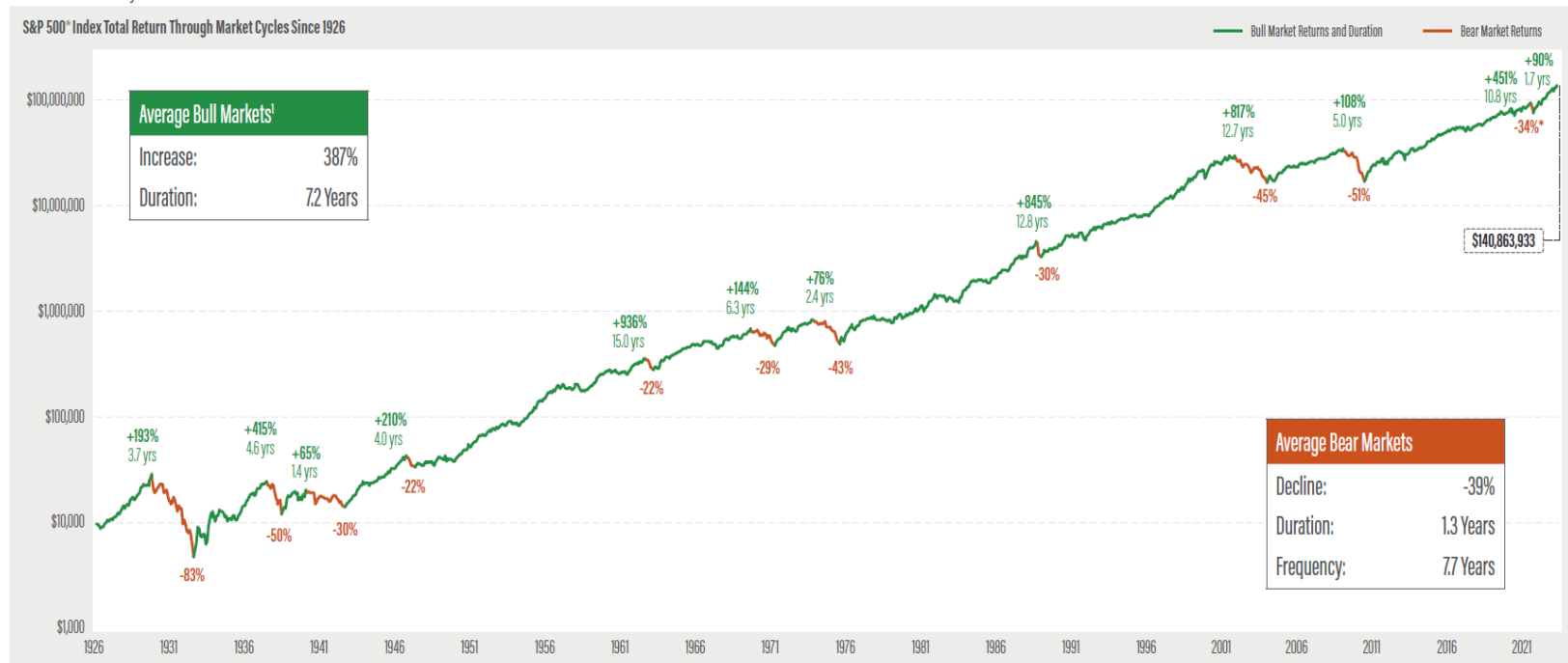
Market Volatility is Extreme

b.) Distribution of YTD bond performance (1928-2022)



Bull & Bear Cycles – An Historical Perspective

The Law of Market Cycles



Source: FactSet, S&P Dow Jones Indices as of December 31, 2021. The index is unmanaged, is not available for investment and does not incur expenses. Daily performance is not available from 1926.
 Past performance is no guarantee of future results.
 ¹ Average does not include current bull market.

* This chart uses monthly returns although this most recent bear market uses daily performance for consistency with the rest of the brochure.



Stay Disciplined and Take Advantage of Volatility

Buffett invests big chunk of Berkshire Hathaway's cash

But the key change during the quarter was that Berkshire's mountain of cash shrank to \$106 billion from \$147 billion at the beginning of the year as it invested \$51 billion in equities. Buffett also spent \$3.2 billion repurchasing Berkshire stock.

- Berkshire Hathaway Annual Meeting, April 30





We'll get you there.

Thank you!

Christopher Moss, CFA®

Senior Wealth Advisor

chris.moss@CLAconnect.com

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Digital Transformation: Helping Clients Leverage Technology

David Chambers, CLA



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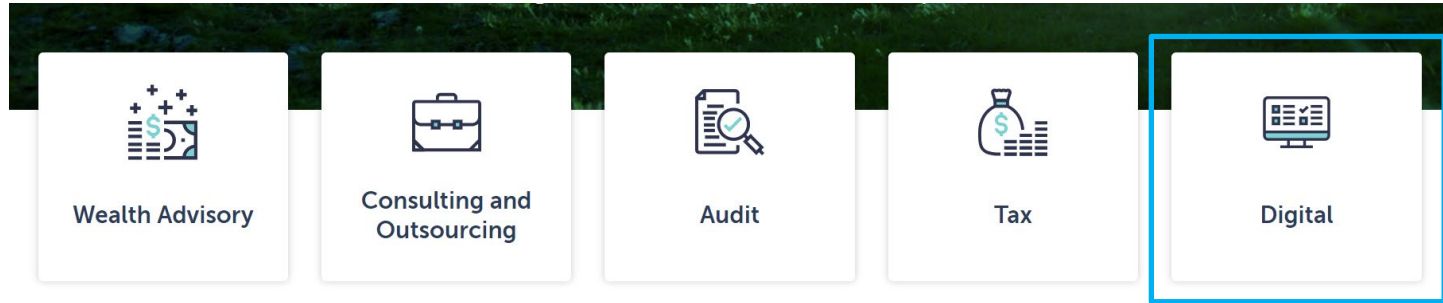
About Me



5 Years as Client Advocate in Data Analytics & Custom App space, prior to CLA



Where is CLA Now?



Collaborative
Approach

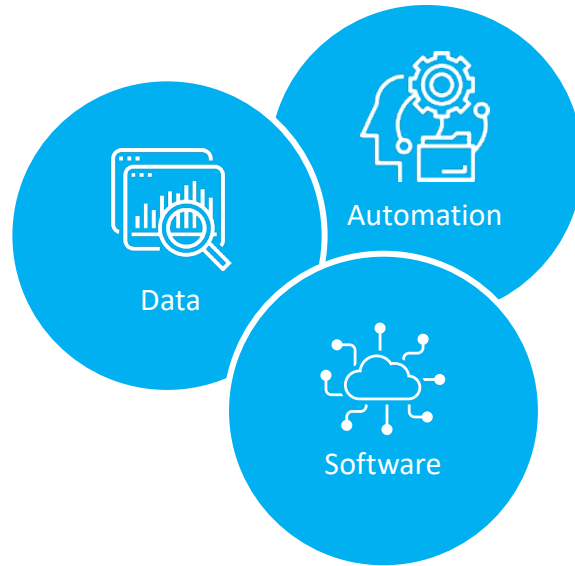
- 7,500 Professionals
- 121 Locations
- 125+ Technologists in Digital



Customer
Focused



Three Pillars of CLA Digital



Data Modernization



Data Modernization

Every business relies on data insights to make their best decisions.

Digital Transformation

Assessments, Road Mapping & Execution

BI Dashboards and Reports

Power Bi and Tableau (Excel too!)

Custom Applications

.Net, Power Apps, Python, Ruby, etc.



Automation



Process Automation

Adding automation to key processes allows businesses to scale efficiently.

Machine Learning

Artificial Intelligence

Data Science

Software Implementation & Integration



Software Integration
Value Added Reseller

Acumatica

Cloud based ERP – M&D

Sage Intacct

Accounting Application Provider

Alteryx

Analytics Automation Platform



When is Digital Engaging with Clients?

- ☐ The business is building key reports via manual data extraction
- ☐ Disparate systems with data everywhere caused by growth
- ☐ Challenged by the Digital Transformation journey
- ☐ Need to Integrate Software Systems
- ☐ No Data Strategy in place today
- ☐ In everyday work – people think “there has to be a better way”



CLA Digital Sample Client Engagement Journey

1. Discovery/Assessment Project – “Phase Zero”
2. POC or MVP Engagement
3. Enterprise Ready Development & Deployment
 - We often first engage with clients that need specific help related to a problem with their technology, reports, and databases. Usually, that problem is merely a symptom.



Client Example: Gleaners Community Food Bank

Challenge

- Thought they needed a new ERP
- Difficulty identifying potential donors & accessing data they needed to answer critical questions

Solution

- Developed a prioritized digital transformation plan
- Creation of a data warehouse with dashboards

Result

- More volunteers, donations, and food served

Client Example: Gleaners Community Food Bank



Implementation Roadmap: Digital Transformation

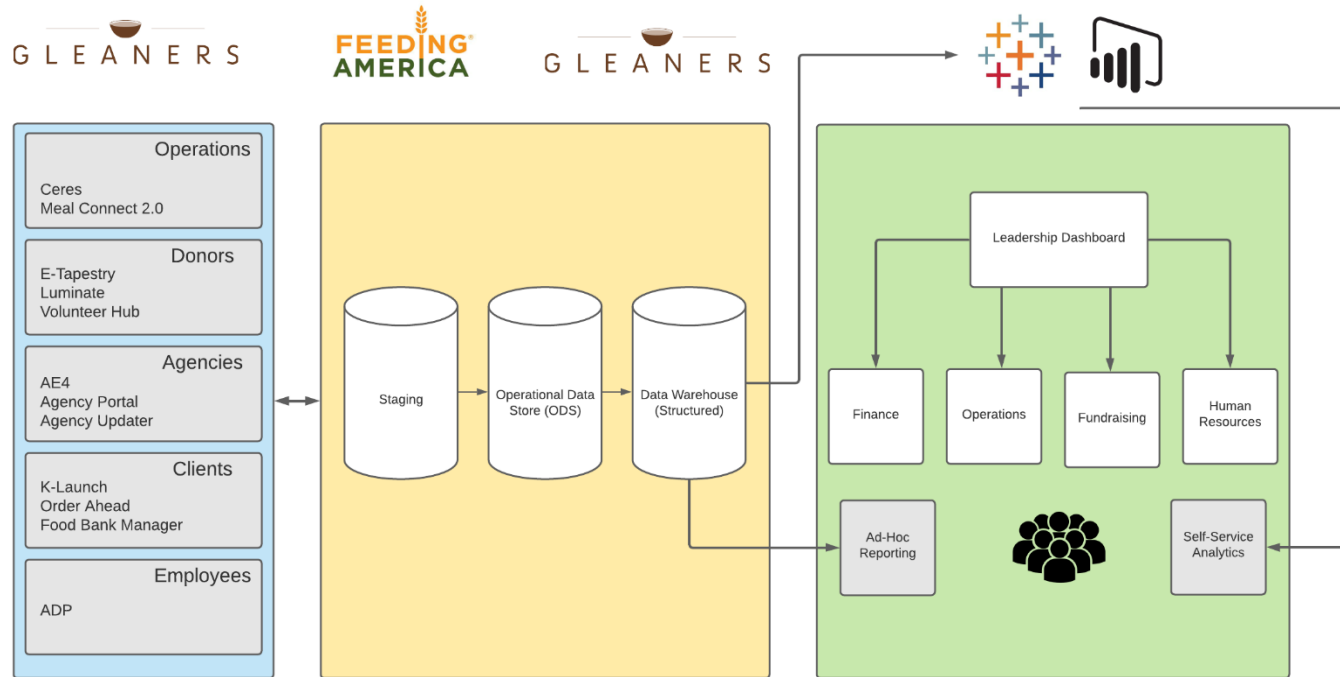


	Description	February	March	April	May	June	July
Application Optimization	Create and finalize Ceres optimization plan						
	Execute Ceres optimization plan						
	K-Launch data ingestion						
	Begin CRM system selection						
Data Warehousing	Determine infrastructure availability and licensing supporting from Feeding America						
	Gather additional data warehousing requirements						
	Design data warehouse schema						
	Data warehouse build (Ceres, Blackbaud, Additional Applications)						
	Data warehouse testing						
	Data warehouse deployment						
Dashboarding and Reporting	Create Board, Executive, and Department-level wireframes						
	Create prototype dashboards from the wireframes at the Board, Executive, and Department-level						
	Create wireframes and prototypes of non-dashboard reports						
	Begin dashboard build-out						
	Begin report build-out						
	Create ad-hoc reporting structure with Service Level Agreements (SLA's)						
	Test and deploy dashboards						
	Test and deploy reports						
User Enablement	User-acceptance testing						
	Begin end-user training						
	Create and execute bug-fix/feature request process						
	Create and execute maintenance procedures						
	Business and technical documentation						
	Complete end-user training						
Project/Change Management	Create change management plan						
	Execute change management plan						
	Create project management plan						
	On-going project management activities						



Client Example: Gleaners Community Food Bank

Gleaners Future State Application/Data Environment



Client Example: Firearms Manufacturer

Challenge

- \$50M more in dead stock then pre-pandemic
- Needed the data to drive supplier conversations and decisions

Solution

- CLA Digital integrated all in-scope systems
- Provided data management
- Provided optimized reporting dashboards

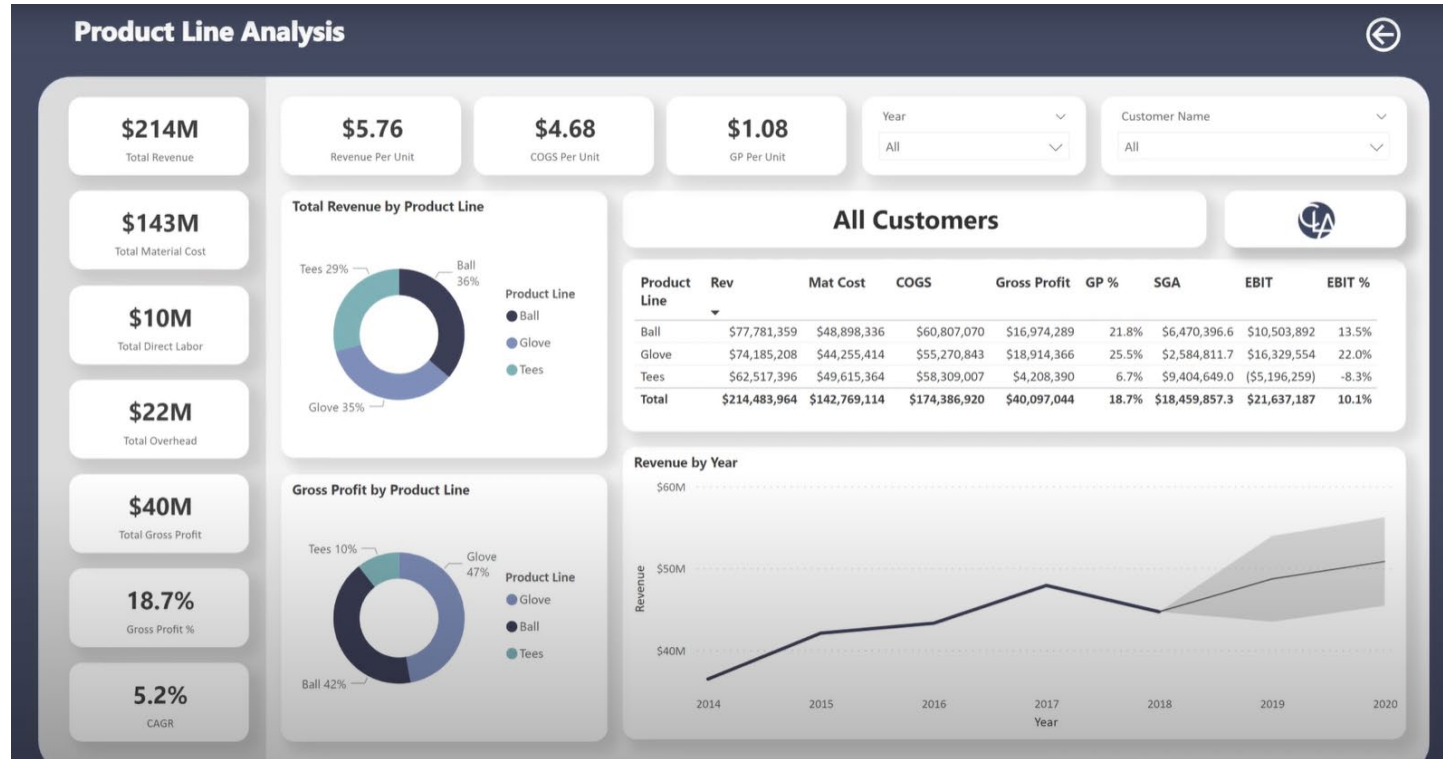
Result

- Improved supplier quality
- Far more insight into their operation
- Long-term vision of getting back to \$10M in dead stock is attainable



Power BI for Golf Equipment Manufacturer

Power BI at CLA - YouTube



Quick Recap – What is CLA Digital?

- We exist to help clients leverage technology to transform their businesses.

1. Data Modernization
2. Process Automation
3. Software Implementation



Collaborative
Approach



Customer
Focused



Any of These Challenges Ring True?

- ☐ The business is building key reports via manual data extraction
- ☐ Disparate systems with data everywhere caused by growth
- ☐ Challenged by the Digital Transformation journey
- ☐ Need to Integrate Software Systems
- ☐ No Data Strategy in place today
- ☐ In everyday work – people think *“there has to be a better way”*





We'll get you there.

Thank you!

David Chambers

Digital Growth Director

david.chambers@CLAconnect.com

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Owner Transition Services

Lisa Horn, CLA

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Learning Objectives

- Know when to start transition planning
- Understand what transition readiness is
- Leave with a tangible 3-step action plan

Why Plan for Transition?

More likely to:

- Meet personal/financial goals
- Leave behind a sustainable company
- Protect your legacy
- Take care of employees/family
- Capitalize on unforeseen opportunities



Why Plan for Transition?

Less likely to:

- Leave money on the table
- Rush the process
- See the business fail post transition
- Experience even greater loss from one of the 5 Ds



The 5 Ds

Death

Divorce

Disability

Distress

Disagreement



Does the next generation understand how much work it is to run a business?
Can this business even support a next generation?
Will my team members feel that I abandoned them?
Who has the knowledge I do?
Is the next generation ready to run the business?
Do my kids even want to be in the business?
Will I be able to fully step away?
Where do I go when I need the business?
How much is my business worth?
What if the next generation can't run it and I have to step back in?
How much money do I need to retire?
Is my leadership team strong enough?
How will my customers handle me not being here?
Will the next owners expect me to work in the business after I sell?
Will my relationship be okay if I'm home more?
If I sell the business how will I know the next owners will take care of my team?

STARTING THIS PROCESS CAN FEEL OVERWHELMING.



Bringing Owners “Peace of Mind”



When Should You Start?

Now.



The Truth Is:

- Your business should be prepared for an exit at anytime
- The fixes are not usually quick fixes – takes time
- Business transition is usually emotionally complex
- Your business is likely your biggest asset; you do not want to make any mistakes



What Do I Need to Do?

- Three Pillars of a Successful Transition
 - ✓ Personal readiness
 - ✓ Personal financial readiness
 - ✓ Business readiness



Pillar 1: Personal Readiness

Plan for what you will do in your next act after exiting your business.



Pillar 2: Personal Financial Readiness?

Prepare financially for a lifestyle without the income from your business.



Pillar 3: Business Readiness

Maximize the transferable value of your business.



Buyer's Eyes

- Financial performance
- Growth potential
- Overdependence
- Cash flow
- Recurring revenue
- Unique value proposition
- Customer satisfaction
- Strength of the management team



Best Thing That You Can Do

- Decentralize yourself – moving from the business being dependent on you to the business being independent of you

Advisory Team

- Owner transition advisors
- Quality of earnings
- M&A/Investment banking
- Talent solutions
- Tax professional
- Wealth advisor
- Valuation
- Gift estate and trust
- Bankers
- Others as necessary



What Does a Good Transition Consist Of?

The owner feels

- They were treated fairly
- A sense of accomplishment
- At peace
- That they have discovered a new sense of purpose
- Proud that the company carried on



Key Takeaways

- Transitions can be complex and take time to navigate well.
- This is likely the biggest financial transaction of your life. Plan accordingly.
- Start early to reduce risk and maximize value and sustainability.
- Surround yourself with the right team of advisors



Action Plan

Over the next 30 days:

1. Visualize where you will be one year after exiting your business.
2. Evaluate your current advisory team? Do you have the right people at the table
3. Identify and make one change in your business or in your behavior to decrease the dependence your business has on you.





We'll get you there.

Thank you!

Lisa Horn, CEPA

Principal

Owner Transition Services

lisa.horn@CLAconnect.com

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Short Break

CLA exists to
create opportunities —
for our clients, our people,
and our communities.



Tax Update

Terri Lillesand, CLA



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100% Deduction for Restaurant Meals

- Meals generally subject to 50% disallowance
- General Exceptions:
 - Social events for employees (i.e. company holiday party)
 - Items available to general public
 - Sold to customers
- **100% deduction for restaurant meals in calendar year 2021 and 2022**
- Restaurant – prepares and sells items for immediate consumption, either onsite or offsite
 - Places selling pre-packaged food or drink not for immediate consumption (grocery store, convenience store) do not qualify
- Per diems –the meal portion is considered from a restaurant for 2021 and 2022.



Business Interest Expense Deduction Limitation

- Small Businesses (< \$27m in gross receipts) are exempt from this rule
- Business interest expense deduction limited to 30% of adjusted taxable income
- Adjusted Taxable Income
 - Taxable income + interest expense + depreciation and amortization
- Amounts disallowed carry forward



Business Interest Expense Deduction Limitation

- Starting with 2022 tax year, depreciation and amortization are no longer added back to compute adjusted taxable income.



Business Interest Expense Deduction Limitation

	2021	2022
EBIDA	100	100
less: interest	-30	-30
less: depreciation	-40	-40
taxable income	30	30
addback: interest	30	30
addback: depreciation	40	
Adjusted taxable income	100	60
percentage	30%	30%
interest expense limit	30	18
Taxable income	30	42



Bonus Depreciation Phaseout

- Currently, can deduct 100% of qualifying property.
- Starting 1/1/23, bonus depreciation drops to 80%
- 20% phaseout per year after 2022



Calendar Year	% of Cost Allowed to be Bonused
2022	100%
2023	80%
2024	60%
2025	40%
2026	20%
2027	0%



Tax Planning for Inventory – LIFO

- **Last In First Out**
 - Method of accounting for inventory
 - Most recent purchases (most expensive) become COGS on income statement
 - Oldest purchases (least expensive) make up inventory on balance sheet

L LAST
I IN
F FIRST
O OUT



Tax Planning for Inventory – LIFO

- Why: Opportunity for recurring tax deductions by increasing cost of goods sold
- When:
 - Inflation is on the rise (get to deduct more expensive inventory first)
 - Inventory quantities are staying flat or going up (happens when business is growing)
- How: Elect on the tax return for the year LIFO is elected
- Watch: When prices start to decline, as income might be created
- Not all inventory must be on LIFO (choose raw materials e.g.)



2020 Employee Retention Credit

- CARES Act created refundable payroll credit for qualified wages paid after 3/12/2020 and before 1/1/2021
 - 50% of qualified wages up to \$10,000 = \$5,000 credit/employee/year
- Eligible employer
 - Fully or partially suspended operations during any quarter in 2020 due to order from a governmental entity due to COVID-19, or
 - Significant decline in gross receipts
 - 1st quarter in 2020 where gross receipts are < 50% for same quarter in 2019
 - Ends when gross receipts are > 80% for same quarter in 2019 (or 12/31/2020 if earlier)



2020 Employee Retention Credit

- Qualified wages in 2020
 - Average **FTE > 100** in 2019
 - Wages paid to employee for time that employee is not providing services
 - Average **FTE ≤ 100** in 2019
 - Any wages paid during qualifying period
 - Includes allocable qualified health plan expenses
 - Coordinate with use of PPP loan proceeds



2021 Employee Retention Credit

- Modifications for 2021:
 - **Significantly** expanded and improved the credit
 - \$10,000 qualified wage limit per employee per quarter
 - Credit percentage is 70% of \$10k (max \$7,000 credit per quarter)
 - 2019 average FTE threshold increased to 500
 - Significant decline in gross receipts < 80% for same quarter in 2019
 - Can elect to “lookback” one quarter
 - If employer did not exist in 2019, look at 2020 gross receipts



Change to Research and Development Expenses

- Currently, all research and development (R & D) expenses are currently deductible.
- Expenses used for the R & D credit, to the extent a credit is generated, are not deductible.
- Starting with 2022 tax years, ALL R *D expenses are not deductible but must be amortized over 5 years.



Pass-through Entities: Schedules K-2 & K-3

- Extensive, complex, new tax forms required to be filed, starting with 2021 tax returns:
 - For pass-through entities only (Partnerships & S Corps)
 - Only if entity reports international activities –OR–
 - If any of the partners/shareholders claim a Foreign Tax Credit, and may need the information
 - The new forms are 20 pages long!
 - Why?
 - To create more transparency and consistent reporting of tax attributes
 - Assist with computing of returns for owners



Pass-through Entities: Schedules K-2 & K-3

- IRS provided an exception for many to not file in 2021
- IRS provided a new exception for not filing in 2022 for partnerships:
 - Limited foreign taxes paid
 - No ownership in a foreign partnership, corporation, branch
 - Direct partners are US citizens
 - Partners are notified no later than 2 months before the due date of the return that they will not be receiving Schedule K-3, unless the partner requests it.



Pass-through Entity Tax Election

- Individuals can only deduct \$10,000 of state income/real estate taxes each year
- States came up with a workaround: allow the pass-through entity to elect to pay the tax instead.
- IRS blessed this in 2020 guidance
- Need to evaluate each state separately as the rules are different.





We'll get you there.

Thank you!

Terri Lillesand, CPA

Tax Principal

terri.lillesand@CLAconnect.com

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Background and Overview of the New Lease Standard

Chris Handrick and Seth Zipperer, CLA

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An Overview

- Amended guidance issued February 2016 for the treatment of leases, including subleases
- Affects all industries
- Lessee will be required to recognize a right-of-use asset and lease liability for substantially all operating and finance leases
- Lessor accounting will remain relatively unchanged
- Enhanced disclosures for lessees and lessors



An Overview

Topic 842 **DOES NOT** apply to:

Leases of intangible assets	Leases to explore for or use minerals, oil, natural gas, and similar nonregenerative resources	Leases of biological assets, including timber	Leases of inventory	Leases of assets under construction
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Why the Change?

Lessee

- Most lease assets and liabilities are off-balance sheet
- Limited information about operating leases

Lessor

- Lack of transparency regarding residual values
- Consistency with leases and revenue recognition



Effective Dates

- NOW!
- Fiscal years beginning after December 15, 2021, ie: Calendar-year 2022
 - **Reflects recent FASB decision to defer by one year**





Lease Determination

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What is a Lease?

A contract, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration.



Lease Determination

- An identified asset
 - Can be explicitly or implicitly specified
 - Supplier has no practical ability to substitute
 - Supplier receives no economic benefit from substituting
- The right to control the use during the lease term
 - Decision making authority over the use of the asset
 - Ability to obtain substantially all economic benefits from the use of the asset





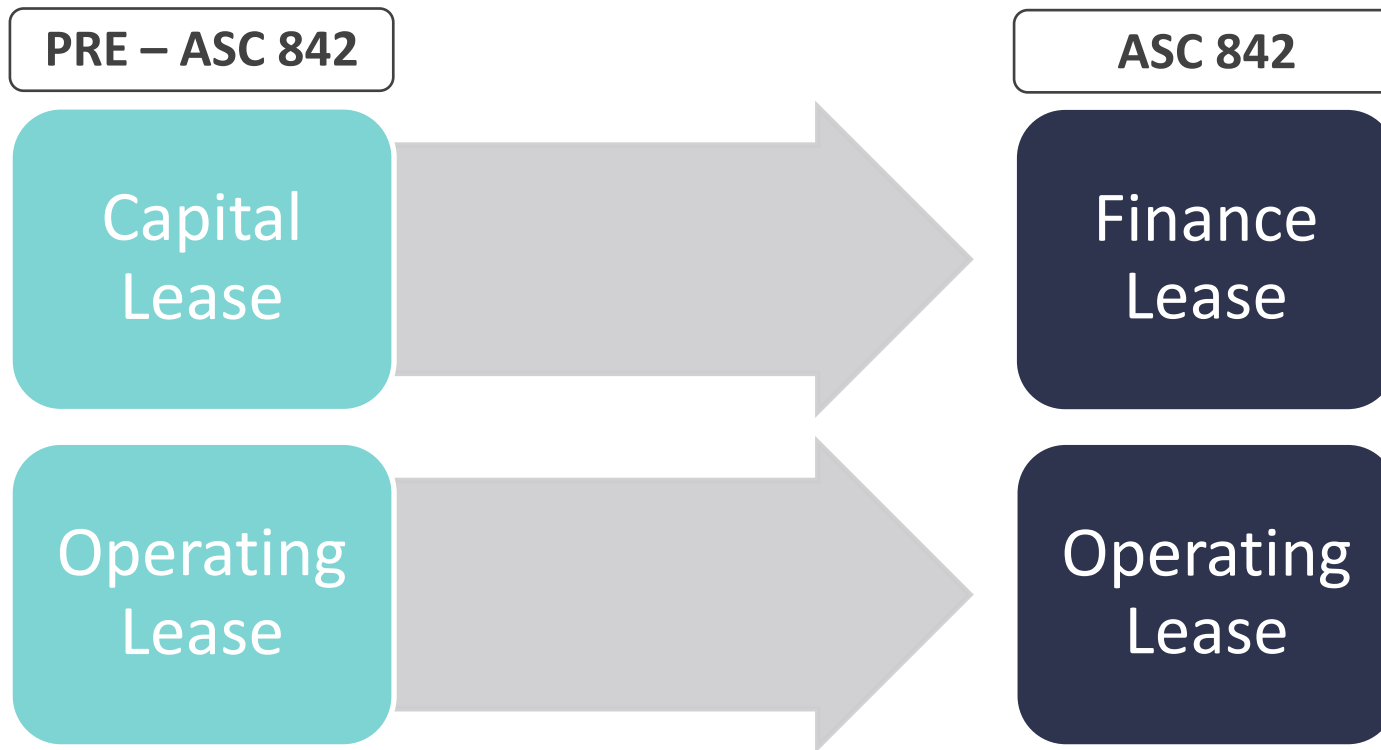
Lease Classification

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Lease Classification Terminology



Lease Classification – Lessee

Financing lease if ANY of the following 5 conditions are met:

Transfer of ownership

Option to purchase is reasonably certain

Lease term is a major part of the economic life (75% or more)

Present value of lease payments is substantially all (>90%) of the fair value of the underlying asset

The underlying asset is of a specialized nature

If none of the above are met, the lease is an operating lease





Recognition and Measurement

Lessee Accounting

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Lease Term – Initial Measurement

- Slightly new definition
 - Noncancellable period for which lessee has right to use the underlying asset, **plus periods covered by:**
 - Option to extend if lessee reasonably certain to extend
 - Option to terminate if lessee is reasonably certain not to exercise
- Reasonably certain
 - Must consider all relevant factors that create an economic incentive for the lessee to exercise the option



Lease Term – Subsequent Measurement

Lessee

- Reassess only upon the occurrence of a significant event/change in circumstances that is within the control of the lessee
 - Absent a modification

Lessor

- Not required to reassess
 - Absent a modification



Lease Term – Other Considerations

- Month-to-Month leases – rent expense when incurred. However, if substance is not truly month-to-month agreements should be revised.
 - Related party leases must follow contractual provisions of the lease agreement
 - Consolidations with related party leasing entities
 - Consolidated financials would eliminate the ROU assets/liabilities so... no calculation is needed on these related party leases in consolidation
- But what about those consolidating/combining supplementary schedules...*
- Supplementary Schedules can exclude 842 for the related party leases **IF** the audit report indicates that the supplementary information was not audited and is presented for additional analysis, and we don't express an opinion on it



Balance Sheet Impact



Right-of-Use Asset – Initial Measurement

- Consists of all of the following at commencement date:
 - Initial measurement of the lease liability
 - Any lease payments made to the lessor at or before the commencement date, minus any lease incentives received
 - Any initial direct costs incurred by the lessee

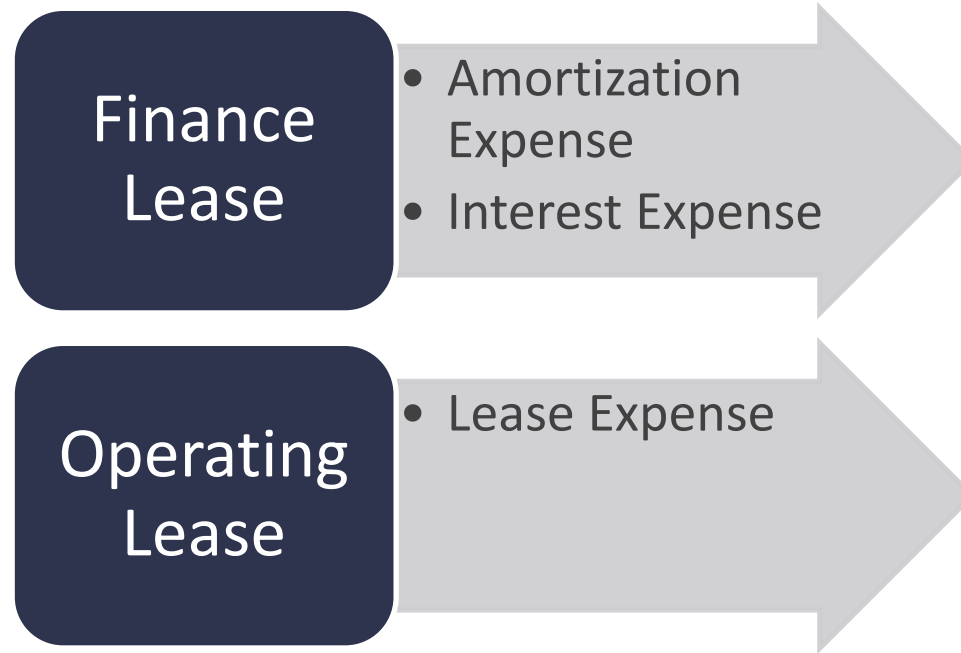


Lease Liability – Initial Measurement

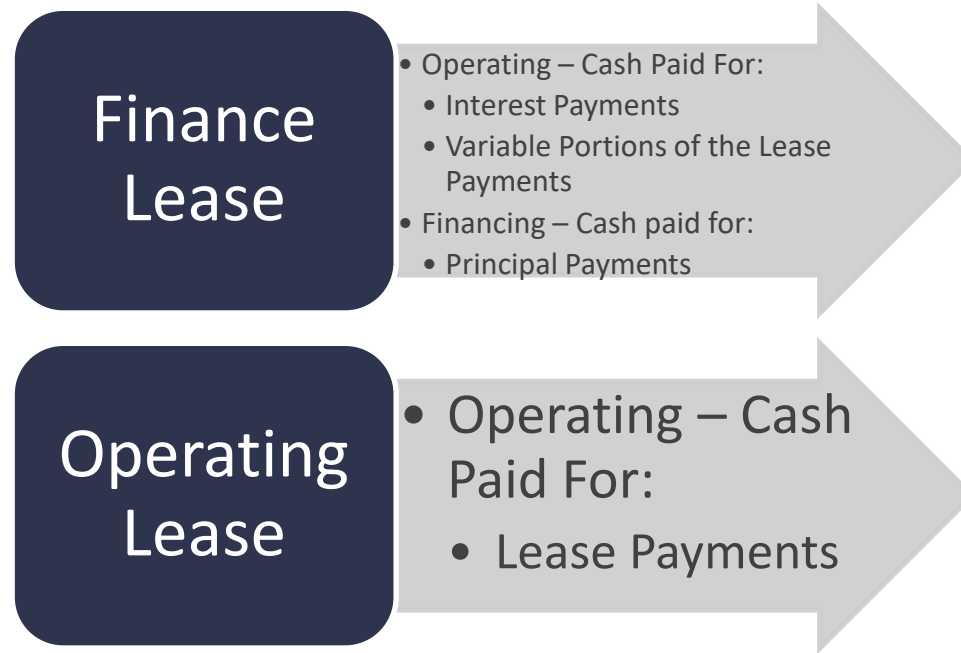
- Present value of the lease payments not yet paid, discounted using the discount rate for the lease at lease commencement
- What if the discount rate is unknown?
 - Use Incremental Borrowing Rate (IBR) – requires significant judgement and evaluation of similar lending conditions and collateral as the lease terms *(likely results in a higher rate/lower ROU assets)*
 - Practical expedient – Elect to use Risk Free Rate with same term as lease *(likely results in a lower rate/higher ROU assets)*
 - ASU 2021-09 allows non-public entities to apply the existing risk-free discount rate expedient by class of underlying assets rather than to all leases



Income Statement Impact



Cash Flow Statement Impact





Other Considerations

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Transition Methods Available

CY = year of
adoption
PY =
comparative
period

Original
Transition
Method (ASU
2016-02)

- CY - 842
- PY - 842

Cumulative effect
adjustment at the
beginning of the
earliest period
presented

Additional
Transition
Method (ASU
2018-11)

- CY - 842
- PY - 840

Cumulative effect
adjustment at the
beginning of the
CY



Transition – Package of 3 Practical Expedients

- An entity need not reassess:
 - Whether any expired or existing contract are or contain embedded leases
 - Lease classification of any expired or existing leases
 - Initial direct costs for any existing leases
- Applies to leases that commenced **BEFORE** the effective date
- Must apply as a package to all leases
 - Can not pick and choose which leases
 - Can not pick and choose which practical expedients



Transition – Hindsight Practical Expedient

- Hindsight can also be elected as a practical expedient
 - Determination of lease term
 - Impairment of right-of-use assets
 - Can be used separately or in conjunction with package
 - Must apply consistently to all leases



Transition – Separating Lease Components

Practical Expedient

- Election to not separate lease components from nonlease components, for example (CAM costs):
 - Insurance costs
 - Tax costs
 - Maintenance costs
- Total lease and nonlease costs under this election would be included in payments used to calculate ROU assets





Presentation and Disclosures

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Financial Statement – Example

- The main area where you will see changes is on the balance sheet and footnotes
- Operating leases: amortization of ROU asset and “interest” on ROU liability payments are recorded as rent expense (same as pre-842)

ASSETS

Current Assets

Cash	\$ 1,000,000
Trade receivables, net	1,800,000
Inventories, net	1,300,000
Prepaid expenses and other current assets	290,000
Total current assets	<u>4,390,000</u>

Property and Equipment, Net

50,000

Other Assets

Right of use assets	400,000
Financing fees, net	10,000
Total other assets	<u>410,000</u>

Total Assets

\$ 4,850,000

LIABILITIES AND MEMBERS' EQUITY

Current Liabilities

Accounts payable	\$ 500,000
Accrued expenses and other current liabilities	100,000
Right of use liabilities - current portion	120,000
Total current liabilities	<u>720,000</u>

Noncurrent Liabilities

Right of use liabilities - noncurrent	230,000
Total noncurrent liabilities	<u>230,000</u>

Members' Equity

3,900,000

Total Liabilities and Members' Equity

\$ 4,850,000



Disclosures

- Objective
 - Enable users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases
- Requirement
 - Enhanced qualitative and quantitative disclosures



Lessee Disclosures – Qualitative

- Nature of leases
- Leases that have not yet commenced but create significant rights and obligations for the lessee
- Significant assumptions and judgements made in application
- Main terms and conditions of any sale and leaseback transactions
- Whether a policy election was made for short-term lease exemption



Lessee Disclosures – Quantitative

- Lease Costs Table:
 - Finance lease cost segregated between amortization and interest
 - Operating lease cost
 - Short-term lease cost
 - Variable lease cost
 - Sublease income
 - Gains/losses from sale and leaseback transactions



Lessee Disclosures – Quantitative

- Segregate amounts for finance and operating leases for the following:
 - Cash paid for amounts included in the measurement of lease liabilities
 - Supplemental noncash information on lease liabilities arising from obtaining right-of-use assets
 - Weighted-average remaining lease term
 - Weighted-average discount rate





Action Items

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What You (as Lessees) Should Be Doing Now

- Begin gathering data on the leases you have now
- Evaluate the processes and controls currently in place
- Decide whether or not to elect optional practical expedients
- Review existing and future debt agreements for covenants



Data Collection and Ongoing Data Management

- Existing systems (e.g., spreadsheets and software) may include some lease information
 - All information required to make the calculations?
 - Judgements (including on going assessments) and information for disclosures?
- Significant effort could be required to manually gather missing lease information



Implementation Considerations



Need a little more help?

- CLA lease implementation resources to assist you
 - Lease calculator Excel Template
 - For up to 5 leases
 - Client involvement with completing templates
 - Turnkey Lease Solution
 - For up to 100+ leases
 - CLA Team drives entire process with client assistance as needed





We'll get you there.

Thank you!

Chris Handrick, CPA

Assurance Principal

chris.handrick@CLAconnect.com

Seth Zipperer, CPA

Assurance Manager

seth.zipperer@CLAconnect.com

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Closing Thoughts – Any Questions?

THANK YOU!



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