

WINTER 2011

# Leading EDGE

PUBLISHED BY



ALPERN ROSENTHAL  
INSPIRING OPPORTUNITIES FOR 50 YEARS

ADVICE & INFORMATION TO HELP YOU MANAGE YOUR BUSINESS



*Risk management*

## WHAT'S THE RISK?

If your company doesn't  
know the answer, it's high

*Plus*

Economic forecasting  
demystified

How to plan for your  
digital estate

## Alpern Rosenthal Celebrates 50 Years

The year 2011 marks the 50th anniversary for Alpern Rosenthal, one of Pittsburgh's leading regional certified public accounting and business advisory firms. From its humble beginnings, the firm has evolved into one of the nation's top 100 accounting firms and one of Western Pennsylvania's largest firms.

"Fifty years is an extraordinary accomplishment for any firm in our industry," said Alex Paul, President of Alpern Rosenthal. "Our success and longevity are attributable to the governing values on which we were established, as well as our dedicated professionals and support staffs who strive to provide the highest quality service to our clients each and every day."

Entrepreneurs Ed Alpern and Irving Rosenthal formed the team that developed into one of the most innovative certified public accounting and business advisory firms. In July 1961, the firm was only a fraction of its current size, with a staff of just one accountant and one secretary. Yet, when revenues doubled in the firm's second year of business, it was clear that Alpern Rosenthal's innovative solutions and dedicated personnel were meeting a vital need in the marketplace.

"As the firm has grown, we are proud to have maintained and obtained high levels of expertise and diversity," Paul continues. "We are always looking to grow our practice and looking for new opportunities in different niches."

Since 1961, Alpern Rosenthal has provided reliable accounting and advisory services to clients throughout the tri-state region, including accounting and audit, business consulting, business valuation and litigation support, employee benefit plans, estate and trust planning and tax compliance and planning. The firm also maintains a strong presence in the manufacturing, construction, real estate, energy, healthcare, emerging business and technology, public company and not-for-profit industries. Alpern Rosenthal has a staff of more than 200 professionals, including 32 shareholders.



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## Alpern Rosenthal Launches Social Media Sites

Alpern Rosenthal announces the launch of a comprehensive social media campaign focused on all things accounting, tax, and business consulting with the debut of LinkedIn, Twitter, Facebook and YouTube. The campaign features a broad mix of informative content and user generated discussions – from the latest news on tax and accounting legislation to forums to discuss anything from customer service to money-saving tips.

"Alpern Rosenthal stands out for its best in class client service and we are pleased to raise the bar yet again for what clients and the public at large should expect from their accounting firm," said Tricia Egry, director of marketing. "With this campaign, the Firm is truly delivering on the promise of social media to create a dynamic and useful knowledge-base that helps people make better financial decisions in their lives and in business."

"We've developed a program centered on providing superior client service combined with useful, engaging content to drive conversations," Egry added. "We're interested in building long-term relationships with our clients through social media and reaching them on the sites where they interact most."

These social channels provide a meaningful platform for dialogue regarding accounting and auditing news, business advisory tips and new Alpern Rosenthal initiatives. Sign up at [www.alpern.com](http://www.alpern.com).



**Leading Edge**  
[www.LeadingEdgeAlliance.com](http://www.LeadingEdgeAlliance.com)

The Leading Edge Alliance is an international professional association of independently owned accounting and consulting firms. The Leading Edge Alliance enables member firms to access the resources of a multibillion-dollar global professional services organization, providing business development, professional training and education, and peer-to-peer networking opportunities nationally and globally, around the corner and around the world.

Members are top quality firms who are very successful, have deep client relationships, and strong ties to the community. The Alliance provides members with an unbeatable combination: the comprehensive size and scope of a large multinational company while offering their clients the continuity, consistency and quality service of a local firm.

Member firms have access to the best and brightest teams of business advisors—a peer-to-peer connection that provides the right business solutions for clients.

To find out more about the Alliance, contact Karen Kehl-Rose, president, at (630) 513-9814 or [kkr@The-LEA.com](mailto:kkr@The-LEA.com).

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Leading Edge is published four times per year by Wise Group, 812 Huron Road, Suite 201, Cleveland, Ohio, 44115, (216) 523-1212, FAX (216) 241-5458. Periodicals postage paid at Cleveland, Ohio.

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# WHAT'S THE RISK?



# If your company doesn't know the answer, it's high

By Dennis Seeds

**Y**our company's been fortunate. The last hurricane missed the headquarters by a mile. A fire suppression system worked well when a motor overheated recently. You feel pretty confident that your risks are under control, right?

Don't get too sure of yourself yet. What about the unseen threat that comes from discontent among employees? And don't overlook executive protection (errors and omissions, directors and officers, crime and fiduciary liability).

Ask yourself, "How do I find out where my company is most vulnerable, and how can I plan, prepare and mitigate the unforeseen?"

One of the best ways to start to identify risks is to use an exposure survey questionnaire, says Jack Gibson, president of the International Risk Management Institute Inc.

"This is a detailed list of questions prepared by a risk management practitioner that focuses on revealing business practices and conditions, which present unique risks to organizations," he explains.

## Diagram the business

Other good tools that identify risks are flow charts, Gibson says.

"They can help identify weak links in a manufacturing process or supply chain that can lead to increased business interruption risks or legal liability (e.g., the use of foreign suppliers)," he notes.

Robert Olszewski, a director in the Audit and Accounting group of Kreisler Miller, a Leading Edge Alliance firm, has similar thoughts. Simplify the risk assessment process in the early phases by creating a chart detailing the flow of all the major factors that impact the company: customers, vendors, pricing, personnel, government regulators, product lines and competition, he says.

"Conduct a brainstorming session that includes cross-functional personnel, management and professional advisors to detail the specific risks associated with each of the major factors," Olszewski adds. "Subsequently, design and implement an action plan to address each of the identified risks to a tolerable level."

This process requires ongoing monitoring with corrective action plans and alterations being made, he notes. "Many entities engage independent advisory boards to assist in this process which include industry peers, professional advisors and other experts that can provide tremendous insight on matters that may have been overlooked."

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# INTERVIEWING EMPLOYEES, REVIEWING PROCEDURES, AND SIMPLY OBSERVING CAN REVEAL QUITE A BIT FOR A TRAINED PROFESSIONAL.

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## **Analyze insurance protection**

Dan Weedon, an insurance and risk management consultant and founder of Toro Consulting Inc., says that for property and casualty insurance, the best way is to consult an unbiased professional, independent of the agent or competitor.

“Have him (or her) perform a diagnostic review of the insurance policies and interview the owners,” he suggests. “The biggest gaps come in owners’ expectation of their protection and what they actually have.”

If an insurance competitor analyzes coverage protection, it can be biased because it wants to sell the coverage, Weedon says.

“From a risk management perspective, a walk-through audit is advisable to view any glaring issues when it comes to safety,” Weedon continues. “Interviewing employees, reviewing procedures, and simply observing can reveal quite a bit for a trained professional. I don’t recommend this be done in-house unless the person doing it has a background in insurance and risk management.”

Agents and brokers should be chosen as carefully as you would choose an accountant

or attorney, taking into consideration their education, qualifications and experience, Gibson says.

“Preferably, choose one that has earned one of the more prestigious insurance industry designations, such as Chartered Property Casualty Underwriter (CPCU), Certified Insurance Counselor (CIC) or Associate in Risk Management (ARM).

Jason Kaufmann of Anderson Insurance and Investment Agency agrees.

“For example, a workers’ compensation review needs to be completed by an agent or risk manager that knows the laws of the states that the employer operates in with emphasis on every area that affects outcomes,” he says.

Pre-hire practices, claims management, medical clinic relationships, whether or not the state allows indemnity payments, reserves and audits are all areas that need to be reviewed. The type of exposure will determine what coverage needs the most attention.

Brian Smith, an advisor with the InsuranceEdge division of American Express OPEN, recommends a professional as well.

“A commercial insurance carrier routinely provides risk control consultants as part of the service offerings,” he notes. “One of the main responsibilities of consultants is to perform risk audits—audits are often assigned by carriers, but can also be requested by the customer.”

## **Communicate with your employees**

Getting the pulse of the workforce is not only important, but essential.

“Audits can often be done by good consultants, including insurance brokers, safety specialists and attorneys,” says Beth Schroeder, an employment and labor law attorney with Silver & Freedman. “However, it is always important for a business to really know what’s going on with its own workforce, and taking surveys of employees or just meeting regularly with the floor managers, and rank-and-file workforce is invaluable.”

Management should always be analyzing what’s working, what’s not, who’s disgruntled, what compensation plans are effective, and the like, she adds.

“The biggest threat does not come from the changes in employment law, but from discontent among employees,” Schroeder notes.

“That discontent not only can generate lawsuits, accidents and audits, it can be the

trigger that spurs a union organizing drive,” she stresses. “The happiest employees tend not to pursue legal violations or outside intermediaries.”

Invest in management training, Schroeder suggests.

“Even if top management understands the compliance issues, it needs to be carried out from the top down,” she explains. “Good intent is irrelevant if the managers are undermining the best efforts of upper management; one stray remark, unfortunate act or failure to report can undercut all the best policies in the world.”

## **Know the deal**

The first thing every business person should know about commercial insurance is that there are many variations among policies as well as options that can be made to improve or restrict coverage with an endorsement, Gibson says.

“A poorly structured program may cost less because it has many coverage gaps, but that doesn’t make it a bargain,” he explains, adding, “Just remember that no one asks how much the insurance costs following a catastrophe—only whether the loss is covered.”

As for property casualty insurance coverage, think of insurance in two baskets, Gibson says.

“One, casualty insurance, covers obligations or legal liability to third parties,” he explains. “Think of it as lawsuit insurance as it covers the cost of defense and the amount of any awards or settlements against the company.”

All organizations need workers’ compensation insurance, commercial general liability insurance and automobile liability insurance. To extend the limits of liability beyond those provided by these basic policies, an umbrella insurance policy should also be purchased, Gibson notes.

“Other types of casualty insurance include employment practices liability insurance, directors’ and officers’ liability insurance and professional liability insurance; the need for these will vary from company to company,” he continues.

The other insurance basket contains various types of property insurance to cover the cost to repair or replace damaged or destroyed property. Options include coverage of the income lost as a result of that damage or destruction (i.e., business interruption) or

extra expenses incurred to maintain operations after the loss.

“The basic building blocks that all organizations need are a commercial property policy to cover real property (e.g., buildings) and/or personal property (e.g., furniture, inventory, machinery) and a commercial crime policy to cover employee theft as well as other crime exposures (e.g., robbery or burglary),” Gibson recommends.

“Some organizations will need to supplement these with other types of insurance such as equipment breakdown insurance and insurance on certain special types of property such as contractors’ equipment, fine art, accounts receivables and jewelry for sale.”

### Workers’ compensation

While workers’ compensation insurance may vary by state, Smith says discounts may be considered from the following actions:

- Initiation of a certified drug-free workplace
- Losses related to workplace injuries kept to a minimum because of a strong safety program
- A deductible on the workers’ compensation program that will have a positive impact on the experience modification factor if you operate in a state that provides such credit
- A meeting or conference call with the underwriter to discuss highlights and management’s commitment to safety
- Claims reported in a timely fashion, within 24 hours, thereby minimizing the cost by engaging the insurance company claims staff

A large part of cost containment in workers’ compensation deals with safety, Gibson notes.

“The most important step for controlling workers’ compensation insurance costs is to have no losses by making safety part of your corporate culture,” he says. “Everyone in the company should take ownership of safety, from the CEO on down; safety should be one of the criteria on which the performance of every manager is evaluated.”

Be careful about comparison shopping for workers’ comp insurance, Kaufmann urges.

“While they may save 5-10 percent by shopping, their experience modification rate

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## Workplace safety takes commitment

*Edwin G. Foulke Jr. was administrator of the Occupational Safety and Health Administration under President George W. Bush. Now co-chair of the Workplace Safety and Catastrophe Management Practice Group at the law firm Fisher & Phillips, he recently spoke to Leading Edge.*

### LE: What is risk assessment?

**EGF:** Risk assessment from a safety context is where employers determine what safety and health hazards exist within their specific facility or worksite based on the specific jobs that are performed by their employees. It determines the degree of risk that each particular safety and health hazard presents within the work site since hazards will vary in degree of severity and potential injury to employees.

### LE: How can an organization find out where it is most vulnerable to safety and health hazards?

**EGF:** For any organization to determine such vulnerability, it will need to conduct several different inquiries to assist in identifying those issues. Specifically, OSHA law requires in certain circumstances that employers conduct job hazard analysis to identify the specific hazards facing the employees. A job hazard analysis normally is conducted internally but could be conducted by a third-party safety professional.

*Job hazard analysis should discover*

- what can go wrong
- what are the consequences
- how could it arise
- what are other contributing factors
- how likely would the hazard occur

*In addition, the job hazard analysis must describe*

- where the specific hazard is occurring
- to whom is it happening
- what precipitates or triggers the hazard
- what is the outcome should the circumstance happen
- any other contributing factors

Part of any job hazard analysis would require the employer to discuss with the

employees any hazards they have identified in their specific job. Furthermore, once the job hazard analysis has been completed by the company, periodic (yearly) audits of the job site, either internally or by third-party auditors, should be performed to assure that old hazards are not recurring or new hazards have not developed.

It should be noted that under the Occupational and Safety Health Act of 1970, there are criminal provisions for willful violations of OSHA standards that result in fatalities where officers and directors of the company could be held potentially criminally liable.

### LE: Can you give some other tips or ideas on how to plan, mitigate and prepare for unforeseen circumstances?

**EGF:** In some cases, OSHA has standards which require the employer to develop emergency action plans or hazardous waste operation emergency response programs. In developing an emergency action plan, the employer should develop procedures for reporting all potential types of emergencies that may occur at that facility, including natural and man-made disasters.

Also, the action plan should include procedures for emergency evacuation, including the type of evacuation and the exit route assignments. In certain operations, the emergency action plan will also include procedures to be followed by employees who remain to operate critical plan operations before they are evacuated.

In addition, procedures to account for all employees after evacuation as well as procedures to be followed by employees performing rescue or medical duties should also be detailed in any type of emergency action plan.

Of course, if an employer has an emergency action plan, then training of all employees, especially those designated to assist in a safe and orderly evacuation of other employees, should be done on a yearly basis.

### LE: Any other points?

**EGF:** All employers should realize that in order to have an effective risk assessment program, the commitment must start at the upper levels and be pervasive at all levels.

*Continued from page 7*

is continually rising year after year because of the lack of proactive measures that are implemented,” he says.

“A workers’ comp expert needs to be utilized who has the ability to help with claims management, establish a medical clinic relationship, review and discuss reserves on open claims prior to the ‘experience mod’ being calculated, strengthen return-to-work programs and so on,” Kaufmann adds.

### **Be prepared**

The challenges of the 21st century make it all the more important to be prepared.

“We live in a fast-pace environment and failing to plan is a major detriment to the success of many entities,” Olszewski observes. “My father wisely taught me at a young age that if you fail to plan, plan to fail.”

Take the time necessary to address the needs and concerns of the company that cause you wake up in the middle of the night, and mitigate risk by addressing matters on a proactive, versus reactive, basis, he recommends.

What are the chances a company won’t bounce back from a calamity?

“Statistics show that about 60 percent of

organizations do not resume business following a major disaster,” Gibson notes. “The organizations most likely to recover have business continuity plans and have trained their employees for response.”

Kaufmann says planning for a disaster is a no-brainer.

“I have seen time and time again where a business has not saved for unforeseen expenses,” he relates. “The businesses that I have seen succeed in this economy were prepared financially to do so.”

Part of being prepared is to know how to report a claim, Smith claims.

“Have a plan in place to investigate losses effectively that may be related to employee injuries, property or automobile issues,” he says.

Think outside the box when you plan for a catastrophe, Weedin says.

“My analogy is sports as I used to coach high school basketball,” he notes. “If you never discuss, plan for or practice a situation, you will most likely fail unless you get lucky. Not planning for an ‘end of the game’ situation is lazy and dangerous.”

Not planning for disaster can have terrible consequences to business survival and to employees, Weedin adds.

“It’s not the most compelling topic; however, time must be made regularly to review, discuss, challenge and practice your processes, procedures, plans and protection,” he says. “Being ambivalent about it and letting it just go without proper planning is asking for trouble.”

Weedin says, “My experience tells me that organizations rarely practice their own ‘fire drills.’”

As a final thought, Smith notes that there are many service offerings by the insurance and risk industry that are usually complimentary.

“By asking a business insurance agent for a list of service and coverage offerings, a business owner has an entire team of professionals at their disposal, a luxury that should be taken advantage of,” he suggests.

“Webinars, press releases, newsletters and insurance programs on claims management and risk control are offered almost on a weekly basis,” Smith adds. “Look to these sources for assistance when trying to uncover improvements to your business risk. The professionals have seen so many operations and claims that their advice and counsel minimizes the business owners’ need to reinvent the wheel.” **LE**

## Check out these blind spots that can sink a company

**By Michael Zeldes, senior vice president of HUB International Northeast**

Here are four blind spots that pose significant dangers that a company may want to consider when conducting a risk assessment:

1. The possibility that a disgruntled employee, especially one laid off due to a downsizing, will sue the company on the grounds of discrimination. Even if there is absolutely no merit to the charge, the business may face \$100,000 or more in legal fees. Employment practices’ liability insurance can remedy this risk by paying for legal bills and possible settlement costs and fines.
2. The need for a business to suddenly shut down all or part of its operations because of a fire or other disaster. This closure may result in loss of substantial income, thus jeopardizing the company’s very existence. Business interruption insurance, however, pays the bills for all qualified cases where the company must temporarily close all or part of its operations. You can think of it as a financial lifeline.
3. A key person is so instrumental to the success of a business that his or her departure because of death or disability can have a profound impact on the company. Fortunately, key person insurance pays a lump sum to compensate for the loss and carry the company until a replacement is found.
4. Individuals who serve as directors or officers of companies are often named in lawsuits against the business and may be liable for damages that can threaten their personal assets. For this reason, it is critical to have directors’ and officers’ insurance, in sufficient sums, to protect the people who sit atop the company.

## INSIDE:

- Business Succession Planning
- Contractors and the IRS DPAD
- Manufacturers Deduction
- Entertainment Expenses



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# Business succession planning— how to make it work

By Michael S. Leone,  
CPA, J.D., LLM  
Shareholder, Tax  
Director, Tax Operations  
(West Palm Beach, FL)

You may be getting ready for retirement after years of hard work and sacrifice building a successful business. You would like to pass on your business to one or more of your children, or possibly to an employee or an outside buyer. This change in ownership is what will fund your retirement. However, the lack of a formal plan of succession can thwart your dream.

The resistance to succession planning can be difficult to overcome. However, it is critical to the continued success of the business that the appropriate plans are made and implemented. As the central figure, you must recognize that the dream of establishing a successful business lasting long into the future and influencing generations can only be realized by planning your exit from the business.

The succession planning process will ideally result in a well-conceived and coordinated plan. It will develop a set of family business policies that will outline how to handle the transition process, how to manage conflict among family members, what the requirements are for family members to enter the business, compensation philosophy, dividends, board appointments, outside directors and managers and similar issues.

Although there are no guarantees, a plan of succession increases the odds that the business will stay within the

family. Consider the following suggestions to help provide for a smooth transition of your business:

## 1 Avoid delay in planning.

Many business owners leave succession planning until the last moment—if they plan at all. An ideal succession plan requires laying the groundwork over many years. How a business owner wants to exit the business tomorrow strongly influences how the business is structured and operated today.

## 2 Don't assume your children will take over the business.

While many children want to eventually take over the family business, not all do. It's critical to talk to them about what they see for themselves. Encourage them to work in the business, but don't pressure them. Determine their desires in order to pursue other avenues if necessary, such as selling to a valued employee or outside buyer.

## 3 Decide if business should be divided equally among heirs.

Ultimately, one person needs to run the company. That's why it's critical to plan well in advance, so you can see who among your children or management team has the talent and genuine desire to run the business. If a child doesn't want to be involved in the business, devise a way to leave that child non-business assets, such as insurance or perhaps non-voting shares in the business.

## 4 Give real authority to your children sooner rather

than later. Many owners never give authority until the day they retire—only to learn that their heirs are not up to the task. Involve them in current business decisions and determinations. Allow them to build the needed relationships with vendors, employees and customers.

## 5 Don't keep succession plans a secret.

Business owners frequently play their succession plans close to the chest. Perhaps they're worried about stirring up family conflicts or they just don't like to talk about the family money. The sooner you can inform your heirs about your succession plan, the sooner they can make their own plans. It also gives you time to modify the plan, if necessary. Keep them informed, perhaps through periodic meetings.

## 6 Start thinking of retirement.

Retirement can be difficult for small-business owners because often their business is the all-consuming center of their life, even their personal identity. Without a clear sense of what an owner will do in retirement, sometimes they drift back to the family business, intervening in business affairs that others have been positioned to manage.

## 7 Devise and execute a buy-sell agreement.

This agreement typically spells out the terms for a buyout of the owner's interest upon his or her death, disability or retirement. For example, it may cover the valuation of the business, the source of proceeds for the buyout and various other provisions.



AN IDEAL  
SUCCESSION  
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OVER MANY  
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However, this valuation is not necessarily binding for estate tax purposes.

It should be noted that continuing to ask the right questions and resolving them is the important concept. Outside experts can be invaluable, particularly someone who can lead internal meetings and ease conflicts through their knowledgeable, objective perspective. With the proper planning, however, this process will ensure the success of the business for many more years to come. **LE**

Mr. Leone has over 30 years of experience in public accounting with national and large CPA firms in the following areas: tax planning and compliance for corporations, partnerships, individuals and not-for-profit organizations; estate, gift and generation-skipping transfer taxation; income taxation of trusts and estates; pre-immigration tax planning for non-resident aliens and international taxation for both foreign investors doing business in the United States and Americans doing business outside the country. You can reach Mike Leone at [mleone@alpernfl.com](mailto:mleone@alpernfl.com) or (561) 689-7888.

# Contractors and the IRS – Are you leaving money on the table?

## The Domestic Production Activity Tax Deductions

**By Steve Ritmiller, CPA  
Shareholder, Accounting  
and Auditing  
Director, Construction Services  
Group (West Palm Beach, FL)**

If you own a construction company and are looking for new ways to improve cash flow, help is at hand, and from a most unusual source: “the IRS.” Several years ago, there were incentives added to the tax code that benefit most construction companies, but many times these benefits are mistakenly not taken. The construction industry is tough enough not to take advantage of such opportunities.

The opportunity that is being referenced is the Domestic Production Activity Tax Deduction (Section 199 of the Internal Revenue Code). These benefits are available to most construction companies (among other certain industry sectors). Section 199 allows a special tax deduction to qualified taxpayers involved in certain domestic production activities. The deduction applies to all taxpayers, including individuals, corporations, estates, trusts, along with their beneficiaries as well as

partners and the owners of S corporations.

In general, the deduction equals a percentage of the net income derived from eligible activities—3 percent in 2005-06, 6 percent for 2007-09 and 9 percent after 2009. However, the amount of the deduction for any tax year cannot exceed the taxpayer’s taxable income or, in the case of individuals, the taxpayer’s adjusted gross income. The deduction also can’t exceed 50 percent of the “W-2 wages” (wages subject to income tax withholding and certain deferred compensation) paid to employees for the year.

As noted, the deduction equals a percentage of the net income from eligible activities. These activities would include the following:

- construction of real property in the United States
- performance of engineering or architectural services in the United States, in connection with real property construction projects in the United States
- manufacture, production, or growth of tangible personal property, in whole or in

significant part within the United States

Purely sales activities and purely service activities are ineligible for the deduction, unless the nature of the services is for construction, engineering and architectural activities.

Construction activities are eligible for the deduction, but only if the construction is of real property performed in the United States. The real property may consist of residential or commercial buildings, permanent structures (akin to docks and wharves), permanent land improvements (such as swimming pools and parking lots), oil and gas wells, platforms, and pipelines, and infrastructure (such as roads, sewers, sidewalks and power lines). Real property doesn’t include machinery unless it is a “structural component”—for example, an elevator. Examples of businesses conducting eligible construction activities are residential remodelers, commercial and institutional building construction contractors, foundation, structure and building exterior contractors, structural steel and precast concrete contractors, electrical, plumbing, heating and air-conditioning contractors. Eligible construction activities do not include tangential services such as moving rubble and delivering supplies, even if the services are essential for construction.

Construction includes “substantial renovation,” but not decoration (or redecoration).

Engineering and architectural services qualify for the deduction,

but only if they are performed in the United States for real property construction projects in the United States. Eligible engineering services consist of consultation, investigation, evaluation, planning, design and management of projects. Eligible architectural services include consultation, planning, aesthetic and structural design and supervision of construction.

There is much more to the deduction under Section 199. The rules are complicated. Although highly technical, the instructions issued by the IRS to Form 8903, Domestic Production Activities Deduction, provide some guidance on the often convoluted computations.

Now for the good news, if you determine that your company has not taken advantage of this tax deduction—it’s not too late. You still can reap the benefits of this deduction by amending your prior year income tax returns and collect your income tax refund. **LE**

Mr. Ritmiller possesses more than 20 years of experience in public accounting with a focus on closely-held companies in a variety of industries, such as real estate, construction, professional services and life sciences. He also advises clients on business management issues, including strategic planning, job cost management systems, cost segregation studies, operational reviews, financial projections and business planning, maintenance of banking and bonding relationships and litigation support. You can reach Steve Ritmiller at [sritmiller@alpern.com](mailto:sritmiller@alpern.com) or (561) 689-7888.



## The production deduction

After a series of adverse rulings by the World Trade Organization (WTO), Congress curtailed its efforts to benefit exporters and instead provided a tax deduction for all manufacturers—whether they export or not.

The American Jobs Creation Act of 2004 (AJCA) repealed the extraterritorial income (ETI) exclusion and established the manufacturers' deduction—also commonly referred to as the Section 199 or domestic production activities deduction. The deduction isn't just for traditional manufacturers. It's also available to eligible construction contractors, engineers, architects, software developers, film producers, energy producers, farmers and agricultural processors. After a five-year phase-in period, the deduction reached its maximum amount in 2010.

### How the deduction works

The manufacturers' deduction permits eligible taxpayers to deduct a specified percentage of the lesser of 1) their income from "qualified production activities," or 2) their taxable income for the year. The deduction may not exceed 50 percent of the W-2 wages a taxpayer pays during the year. Wages not allocable to domestic production gross receipts are excluded from W-2 wages for the purposes of the deduction.

The specified percentage phased in from 2005 through 2009 and reached its maximum amount in 2010, going up from 6 percent in 2009 to 9 percent

in 2010 and thereafter. As a result, in 2010 the deduction will lower the maximum effective marginal tax rate on qualifying income from 35 percent to 31.85 percent.

Qualified income is calculated by taking gross receipts from domestic production and subtracting the cost of goods sold and other allocable costs, deductions, expenses and losses. Domestic production gross receipts are those derived from any lease, rental, license, sale, exchange or other disposition of the following:

- Qualifying production property (including tangible personal property, computer software and certain sound recordings) manufactured, produced, grown or extracted by the taxpayer in whole or in significant part in the United States
- Qualified films produced by the taxpayer
- Electricity, natural gas or potable water produced by the taxpayer in the United States
- Domestic production gross receipts also include receipts from construction and engineering or architectural services performed in the United States.
- Two significant exceptions are receipts from the sale of food and beverages prepared by taxpayers at retail establishments and the transmission or distribution of electricity, natural gas and potable water.

Additionally, the deduction isn't allowed in determining net



earnings from self-employment and generally can't reduce net income below zero. But it can be used against the alternative minimum tax (AMT).

### Looking more closely

The manufacturers' deduction provides many companies with a potentially significant tax break. But the rules are complex, so be sure to take a closer look at whether you might qualify and what you need to do to maximize your tax savings. **LE**

Lawrence Barger is the director of the Manufacturing Services Group in Pittsburgh. He has significant experience assisting closely held, middle market companies in reaching their financial goals. He provides the following services to his clients: accounting, auditing and financial reporting under United States and International principles and standards; inventory consulting and internal control reviews; buyer and seller due diligence services; general business and financial consulting; and employee benefit plan audits and consulting. You can reach Larry Barger at lbarger@alpern.com or (412) 281-2501.

# Take care when mixing business with pleasure

## How to substantiate entertainment expenses

**E**ntertainment and recreation have always played an important role in business. And while the IRS and courts pore over tax deductions for these activities, they also recognize that businesspeople conduct legitimate business over lunch or on the golf course.

The scrutiny isn't surprising. After all, entertainment is an area that's ripe for abuse. But if you follow the rules, you can successfully mix business and pleasure without giving up the tax benefits.

### Supporting your entertainment expenses

Generally, your company can deduct "ordinary and necessary" business expenses. But the tax code imposes additional requirements on entertainment expenses.

To support an entertainment expense deduction, you must be able to show the following:

- The expense is directly related to or associated with the active conduct of your business—an expense may be "associated" with your company if the entertainment directly precedes or follows a "substantial and bona fide business discussion"
- The deduction is adequately substantiated by records (or other evidence) that establish the amount, time, place and business purpose of the expense, as well as the business relationship of the parties involved
- You had "more than a general expectation" of gaining a business benefit from the entertainment
- You engaged in some business activity, other than the entertainment, such as a meeting, negotiation, discussion or other bona fide business transaction
- The "principal character or aspect" of the combined business and entertainment was business
- The expense was attributable to you, your employees or others involved in conducting business

Keep in mind, otherwise allowable deductions for meals and entertainment are generally reduced by 50 percent. (See the sidebar "In pursuit of a free lunch.")

### Hunting—and fishing—for tax deductions

The case of *Townsend Industries Inc. v. United States* provides some important lessons for businesses deducting entertainment expenses. In this case, the Eighth U.S. Circuit Court of Appeals reversed a district court and held that the cost of a company's annual fishing trip was both deductible as a business expense and excludible from employee compensation as a working-condition fringe benefit.

Townsend was an Iowa-based manufacturer of printing equipment. Each summer the company gathered all its independent sales representatives for a two-day meeting at its headquarters. Following the meeting, Townsend sponsored a four-day, expense-paid fishing trip for its sales reps and factory employees at an upscale Ontario resort. Employees were encouraged, but not required, to attend. Although business discussions were conducted on an ongoing basis and one dinner meeting was held, workers were generally free to do as they pleased during the trip.

The IRS challenged Townsend's treatment of the trip expenses, contending they constituted wages that were subject to employment and income taxes. The district court agreed, finding:

- The "fishing trips were not an ordinary and necessary business expense in light of the lax attendance policy for the trip"
- There was "a disconnect between the sales meeting and the fishing trip"
- The company had no more than a general

expectation to derive uncertain future benefits from the trips

The court also found Townsend failed to meet substantiation requirements, citing the company's lack of contemporaneous, written records—details on why the expense is business related—and its reliance instead on employee testimony.

The Eighth Circuit court disagreed, ruling that, despite the lack of contemporaneous records, trial testimony clearly established the fishing trips had a legitimate business purpose. Even though the trips were voluntary, employees "felt an obligation to attend, and some felt it was part of their job." Moreover, there was "extensive trial testimony" regarding specific business issues discussed and problems solved during the trips.

Although *Townsend* confirms the deductibility of travel and entertainment expenses that serve legitimate business purposes, the case also highlights the importance of substantiating these expenses with detailed, contemporaneous records.

So before incurring entertainment expenses, consider both their potential deductibility and whether they could have any other negative impact on your business. If you determine an expense is worthwhile, be sure to substantiate it. **LE**

For more information on supporting entertainment expenses, please contact your Alpern Rosenthal tax representative.

## In pursuit of a free lunch

Businesses are generally limited to deducting 50 percent of otherwise allowable meal and entertainment (M&E) expenses, but there are several exceptions, such as expenses:

- Treated as compensation to employees
- Excludible from employees' income as de minimis fringe benefits
- Paid or incurred under a reimbursement or similar arrangement in connection with the performance of services
- For employee recreational or social activities—for example, picnics and holiday parties

Separately identifying and reporting items that are 100 percent deductible can be complicated and time consuming. If you spend a great deal on M&E expenses, it may pay to do so. The IRS now allows statistical sampling methods to be used to estimate the portion of M&E expenses that are fully deductible, which can ease the accounting burden.

## Planning your digital estate? Just get your FAQs together

By Dennis Seeds

Succession planning is important. If you happen to become incapacitated or die, instructions on what to do and who should do it are invaluable to your organization. But many people don't think to plan for succession of their electronic information.

"It's difficult to know where our survivors would start, other than that they would likely be overwhelmed," says Dennis Kennedy, an information technology lawyer and legal technology writer. "Therefore, planning for digital assets is becoming part of good estate planning and succession planning."

Kennedy recommends taking a moment to do a mental exercise.

"Can you quickly and easily find all the valuable documents and files on your computers?" he asks. "Or, as is likely, are they scattered among many folders, several computers, flash drives and backup CDs, DVDs or tapes? How easy will it be for someone to sit down at your computer and find everything they need, especially if it's now a struggle for you to do so?"

Storing logon and password information on a USB flash drive and keeping it in a safe deposit box or secure place can be a possibility, says Sassan Hejazi, director of Kreischer Miller's Technology Solutions Group, a Leading Edge Alliance firm.

"You need to make sure the drive is in a safe and preferably encrypted to reduce chances of unauthorized access," he adds. "There also are websites such as legacylocker.com being introduced out there."

Consult a legal professional in regard to the best alternative, Hejazi suggests. He notes that a surviving family's claim to any digital information would depend on each individual website's policies and the deceased's will.

Jeffrey Locketz, managing director of Lurie Besikof Lapidus & Company's Technology Partners, a Leading Edge



Alliance firm, says you should not use business encrypted flash drives to store personal data.

"This is never a good idea," he explains. "If there is a need to access the user's business files, the system administrator should reset the password and provide it to the individual who needs access."

This prevents the password from falling into unintended hands and it alerts the user if someone has accessed the files because the password has changed, Locketz adds.

As for the type of data stored on a computer, Locketz says a firm's policy should be that only company data be stored on company systems.

"When someone terminates, the data is transferred to HR for distribution to those taking over the person's responsibilities," he notes.

Hejazi warns of the danger of leaving accounts active after an employee's departure.

"If an account is not terminated, however, account login information stays in the active file, so unauthorized users might be able to login into a system or application pretending to be the user," he cautions.

"It is critical for organizations to set up and enforce policies to ensure that those with administrative access only use specialized accounts to set up system maintenance tasks," Locketz adds.

"When a staff member or owner with administrative access leaves an organization, care must be taken if that user set up administrative tasks using his or her login credentials," he says. Disabling or eliminating the user account could cause unintended consequences, such as a backup program failing to run.

Kennedy suggests taking five steps to manage your digital estate and update them regularly:

- Inventory your digital assets.
- Identify appropriate help.
- Provide for access.
- Provide instructions.
- Give appropriate authority.

"If you take time to work on the five-step plan, ideally in connection with updating your estate plan, you'll help make things easier for your survivors and improve the chances that your wishes are followed," Kennedy recommends. **LE**

# Ouija board, Nostradamus?

## There are better ways to make an economic forecast

By Dennis Seeds

There are probably few challenges more daunting than trying to make predictions during times of economic uncertainty. Do you look to leading indicators, lagging indicators or both? Do you listen to fiscal conservatives or risk-takers?

While economists argue over the accuracy of the various indicators, there is no denying that these indicators do have attributes that lead the overall economic cycle and therefore pose some usefulness.

Many economic forecasters, as well as the news media, look to the Conference Board as the granddaddy of data. This research association issues economic data and analyses to help world organizations as they gaze into their crystal balls.

The Conference Board releases indices of the three main economic gauges:

**Leading indicators:** those that typically change before the economy as a whole changes. They can be useful to predict the economy in the short term. Examples include stock market returns, new weekly jobless claims and new orders for consumer goods/materials.

**Coincident indicators:** those that change with the economy. They are useful to see a current picture of the economy. Examples include payroll and personal income.

**Lagging indicators:** those that change after the economy does. These can serve to confirm long-term trends, but are, for example, often too late for investors to enter a position. Examples include the average length of unemployment, the Consumer Price Index and the inventories-to-sales ratio.

“As a gauge of what we can expect for the near future, I like looking at the weekly initial claims for unemployment insurance to get an idea whether firms have started hiring or are downsizing,” explains Goran Skosples, assistant professor of economics at Ohio Wesleyan University.

Eric Janszen, economics and finance analyst, founder of iTulip.com, and author of

*The Postcatastrophe Economy: Rebuilding America and Avoiding the Next Bubble*, says he feels housing starts and building permit figures tell more than just the health of the residential real estate sector.

“Except for the World War II era when consumption fell to 50 percent of Gross Domestic Product (GDP) from a high of 81 percent in 1933, there has never been a period of economic growth in the United States when the housing market was not growing,” he explains.

“The reason is that housing prices are over long periods of time tied to household purchasing power, both incomes and credit. As goes housing, so goes the economy.”

Skosples echoes that thought, adding, “If housing starts pick up because more people are buying homes, a car manufacturer may expect a decrease in sales and people will not buy cars since they are buying homes.”

Betting on real estate figures is not so clear for Bruce Fenton, president and founder of Atlantic Financial Inc.

“Housing starts may or may not be as meaningful as some say,” he cautions. “I tend

to look at the very big picture stats. If 70 million baby boomers retire, for example, that is a lot less people in the workforce, spending and consuming, even if conventional indicators don’t track it.”

Some monthly indicators are well worth watching, says Rick Keller, a certified financial planner and CEO of The Keller Group.

“On a monthly basis, I like to watch the Institute for Supply Management Report on

“I OWE THE SUCCESS OF MY FORECASTS TO A COMBINATION OF QUALITATIVE AND QUANTITATIVE ANALYSIS. IT’S MORE ART THAN SCIENCE.” – ERIC JANSZEN



Business,” he notes. This report shows numbers for manufacturing and nonmanufacturing industries.

“The nonmanufacturing numbers report is probably more important because it is probably 80 percent of our economy,” he says.

It’s a good monthly statistic as to what purchasing managers are seeing in their own business, Keller notes.

“Numbers above 50 percent mean growth and numbers below 50 percent mean contraction. So we are looking for that to always be north of 50 percent.”

What does it all mean? Analysts differ, but most say it’s a good idea to get several viewpoints.

“Like in the case of financial planning or being diagnosed with a medical condition, it is usually not a bad idea to get several perspectives,” Skosples advises. “It is hard to take any extreme position very seriously in its entirety, but there is some value in listening to all positions.”

Janszen divides the forecasters along the lines of cycles.

“The companies I consult for work with a range of experts; however, I don’t see them dividing the forecasting field between fiscal conservatives and risk-takers,” he says.

“I see the field divided between the pro-cyclical and counter-cyclical forecasters. The pro-cyclical forecasters identify trends already in place and tend to influence planning by extrapolating the trend. The counter-cyclical forecasters encourage investment when it’s hardest, when prices are beaten down.”

Fenton makes note of political promises.

“In most decisions, it makes sense to get a lot of options and data before not only making a decision but in formulating the right questions,” he advises. “I like to listen to entrepreneurs, people who understand real business, people who have been right and people who understand the globe. I usually avoid politicians.”

Keller said it is rarely a good idea to get guidance from several forecasters.

“The economy is so local and most of the

statistics are more national in terms of how they’re put together,” he explains. “I think regional statistics would be far more important to local economists and therefore they probably would be the best source of information.”

So, what’s the bottom line about an accurate forecast? Janszen offers this admission:

“I owe the success of my forecasts to a combination of qualitative and quantitative analysis. It’s more art than science.” **LE**

## ANALYSTS SHARE THEIR TAKE ON WHAT’S AHEAD FOR 2011:

### **Rick Keller, a certified financial planner and CEO of The Keller Group:**

I think slow growth is the most likely scenario, but with significant enough risk to the downside that one needs to be diligent because the probability of something going wrong is still uncomfortably high.

I don’t like to refer to the bond market’s rally as a bubble, although there is a tremendous amount of money being invested in bonds. But the majority of that money has been invested because of fear as opposed to most bubbles generated due to the greed side of investors’ psyche.

Many of my discussions with clients involve the direction of the economy mostly due to political policymakers. I really think there was a great deal of interest in November’s election and its outcome.

### **Bruce Fenton, president and founder of Atlantic Financial Inc.:**

Doom, gloom and a continually overregulated, clueless and less competitive American economy that has abandoned capitalism, reason and our core values in exchange for smoke, mirrors and stupidity.

### **Eric Janszen, author of *The Postcatastrophe Economy: Rebuilding America and Avoiding the Next Bubble*:**

If compelling leadership does not arrive on the global monetary policy scene within a few months to settle the growing international dispute over how to manage the transition to a new, more workable currency regime, 2011 will be chaotic.

### **Goran Skosples, assistant professor of economics, Ohio Wesleyan University:**

I expect a modest recovery in terms of economic output and a slight decrease in the unemployment rate. Inflation seems to be under control and the Fed has a whole toolbox ready to combat inflation if it surfaces.

I am afraid that the government will decrease its spending in an attempt to satisfy fiscal worries. Business private investment has decreased tremendously in this recession and only the government can substitute. I don’t see house prices recovering in 2011 and I also do not see lending increasing by a significant amount.



# bits & pieces

## OPTIMISM FUELS JOB-HOP THINKING

More than one in five currently employed Americans would change jobs now if given the opportunity, a survey by GfK Custom Research North America says.

However, 53 percent would prefer to stay with their current company even if they were offered a good job elsewhere, according to the survey.

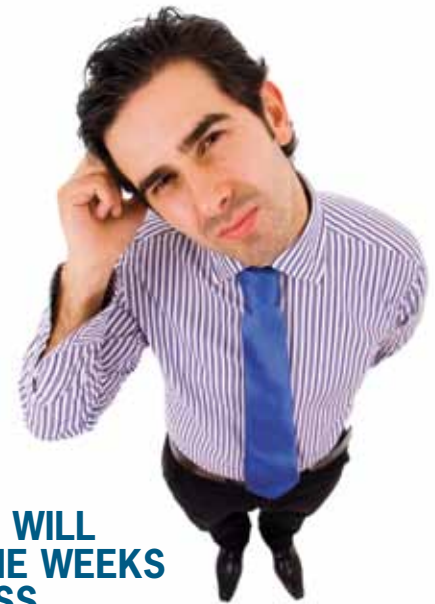
Historical perspective shows that during recessions, employees are far less likely to change jobs, while employers tend to lessen their investments in employee training and development in an effort to keep overhead lower.

The survey of 533 employed adults was weighted to ensure accurate and reliable representation of the total online population, 18 years and older, and screened for employment status.

“This number is important to watch as the economy continues to improve,” notes Thomas Hartley, vice president of GfK Customer Loyalty and Employee Engagement. “Employees are more likely to stay with their company during lean times, and so companies may have taken them for granted.

“When the economy strengthens, experience tells us that employees will begin weighing their options and considering other jobs,” Hartley continues. “Since it takes up to 12 months to improve employee engagement, companies need to plan ahead and take the proper steps to ensure their employee retention rates remain high.”

Two findings suggest an increased optimism among working Americans: 47 percent are confident that the economy will recover in the next year, and 80 percent are confident that they will be able to stay in their job for at least the next year.



## NEWBIES WILL TAKE NINE WEEKS TO ASSESS

Advertising and marketing executives interviewed in a survey say it takes about nine weeks, on average, to determine if an employee is well-suited for the job, according to The Creative Group.

The study conducted more than 500 telephone interviews—about 375 with marketing executives randomly selected from companies with 100 or more employees and 125 with advertising executives randomly selected from agencies with 20 or more employees.

The Creative Group offers five tips to help professionals adapt promptly to a new work environment:

- **Clarify expectations.** Within the first few days, meet with your manager to discuss your responsibilities, immediate priorities, how your position fits into the company, and how performance will be evaluated. Request feedback several weeks into the role to make sure you're on the right track.
- **Watch how people work.** Spend some time studying when employees generally arrive at and leave the office, their preferred communication styles and how they collaborate.
- **Make friends.** While you want to get to know everyone on your team, pay particular attention to those you'll need to rely on heavily.
- **Mind your meeting manners.** Pay attention to how meetings are run.
- **Offer ideas, when appropriate.** Wait until you've proven yourself and built rapport with your coworkers before proposing drastic changes. Your first priority is to earn people's trust.

## FREEST ECONOMY STILL IN HONG KONG

Hong Kong remains the world's freest economy, according to the Cato Institute's Economic Freedom of the World: 2010 Annual Report. This marks the 14th consecutive year Hong Kong has topped the ranking.

The Economic Freedom of the World report uses 42 different measures to create an index ranking economies around the world based on policies that encourage economic freedom.

The report measured economic freedom in five different areas:

- Size of government;
- Legal structure and security of property rights;
- Access to sound money;
- Freedom to trade internationally;
- Regulation of credit, labor and business.

According to the report, Hong Kong's rating for economic freedom is 9.05 out of 10, followed by Singapore with 8.70. The United States is the sixth place at 7.96.

"Our adherence to the free-market philosophy has enabled us to weather the global economic crisis and better position the city as an international financial, business and logistics center," says Donald Tong, Hong Kong Commissioner to the United States.



## TIPS FOR ENGAGING A MULTINATIONAL TEAM

One of the challenges facing some corporations is having employees who speak different languages, live in different cultures, and have different religious beliefs, ethnic backgrounds and values.

"Because of these differences, companies are challenged to engage multinational teams while at the same time promoting a work environment that respects and supports employee diversity," says Kevin Sheridan, CEO and chief consultant of HR Solutions Inc.

Sheridan notes that HR Solutions' research has found that a positive correlation exists between diversity and employee engagement.

"For employees who rate their organizations as treating both employees and customers of diverse backgrounds fairly, employee satisfaction and engagement are also more favorable," he adds. "Strong performance on diversity measures is linked to engagement, which is connected to a company's bottom-line financial performance."

Global companies should aim to increase their employees' perception of corporate diversity efforts, which will ultimately lead to increased levels of employee engagement and reduced turnover, Sheridan says.

"The best practices for engaging a diverse, multinational team are similar to those used to engage employees in any company; however, implementing such practices across continents requires a sustained, organized effort that recognizes and embraces cultural differences," he explains. Sheridan gives the following tips:

- Communicate the importance of diversity throughout the organization.
- Model desired behaviors through the actions of company representatives.
- Offer resources about diversity for recruiting, training and educational purposes.
- Highlight likely scenarios requiring diversity awareness in the organization.
- Introduce a company-wide charitable contributions program where employees can request matching donations to organizations/associations representing people of diverse backgrounds.

## FEEDBACK IS USEFUL, ESSENTIAL

Feedback is not only useful—it's essential, says a motivational psychologist and author.

"Much of the feedback that managers give isn't all that motivating," notes Heidi Grant Halvorson, author of *Succeed: How We Can Reach Our Goals*, as well as author and co-editor of the academic book, *The Psychology of Goals*.

"Even with the best intentions, feedback can easily backfire, and many of us have a hard time understanding why."

She explains that there are three simple rules for giving feedback:

- **When things go wrong, keep it real.** Don't de-motivate an employee by taking away a sense of responsibility for what went wrong. Without honest feedback, the employee can't possibly improve.
- **Fight employee self-doubt.** When you are a manager, helping your employees figure out how to do it right is just as important as letting them know what they are doing wrong. Avoid praising employee effort when the effort fell short.
- **When things go right, avoid praising ability.** Instead, praise aspects of your employee's performance that were under his or her control.

"It's hard to get motivated, and impossible to stay motivated, when you aren't sure if you are on the right track,"

Halvorson says. "So giving well-crafted, frequent feedback is one of the most important responsibilities of any leader or manager."



## No raises? More work? Think creatively to reward employees

**Q:** We've had layoffs the last couple years and have had to ask our smaller staff to do more with a lot less. Unfortunately, we haven't given raises since 2008 and won't be able to in 2011. We also can't reduce their workloads. How do I keep up morale and retain our employees in these challenging times because frankly, I'm afraid we're going to be losing people once the economy stabilizes?

**A:** The past few years have been difficult ones for both employees and companies. Most of us have been faced with having to do a lot more with a lot less and have had no money for raises or bonuses. But we also know that it is critical to do something to acknowledge our employees' contributions and loyalty. Recognition is especially critical in light of statistics that say up to 40 percent of the workforce will be looking for a new opportunity once they feel the economy has stabilized.

Sometimes the best and most meaningful recognition is the simplest. And it is the easiest to let slip when we're trying to keep our operations running. Too often we do not take time for the one thing that has no cost, namely, honest, timely praise for workers who do a great job.

### Take a moment to rate your own performance in this area:

- Do you take time to personally congratulate employees who do a good job?
- Do you write personal notes acknowledging good performance?
- Do you publicly recognize employees for good performance?
- Do you take time to celebrate your successes?

You have the ability to personally impact morale and productivity through your own actions and you set the standard for the organization.

In addition to daily recognition, look for simple, cost-effective ways to honor top



performance. Again, these do not have to be costly and you do not have to provide the same type of recognition to everyone. A reward that acknowledges the individual's interests or includes his or her family is often welcomed more than a spot bonus received by everyone.

### Think about some of these ideas:

- Dining certificates to a favorite restaurant with money for a babysitter if there are small children
- Tickets to a local sporting event with hot dogs included or to a movie theater with popcorn thrown in
- Tickets to a local theme park or other type of entertainment venue
- Gift cards to a grocery store or a specialty store of interest to the individual
- Car washes or oil changes
- A preferred parking space if your company is a bit larger
- An extra day of vacation or a half-day off to take care of personal business that the employee would normally save for the weekend
- A flexible work schedule with the ability

to come in to work later or leave earlier

- The opportunity to work virtually

These types of individual recognition are limited only by your imagination and for the most part, they do not cost a lot of money. You have the ability to tailor the recognition to the employee, showing him or her that you recognize that he or she has interests outside of work that are important too.

So take stock of your own efforts to say "thank you" and recognize a job well done and equally use creative recognition to reward individuals in your organization who have made a difference. A little creativity goes a long way. Drop me a line at [jgrenis@sikich.com](mailto:jgrenis@sikich.com) and let me know your creative ideas. **LE**

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**Got a question for a Leading Edge Alliance firm HR expert? Send them to Editor Ann M. Gynn at [ann@wisegroup.com](mailto:ann@wisegroup.com).**



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