FALL 2015
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THE NEWSLETTER OF THE BDO RESTAURANT PRACTICE

SELECTIONS

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HOW THE RESTAURANT CFO ROLE IS EVOLVING

By Dustin Minton

Until recent years, a restaurant CFO job description required accounting experience, street smarts and good character.

Today, the recipe also calls for strategic, forward-looking thinkers who have the ability to forecast market fluctuations, understanding of IT systems and knowledge of law. In addition to managing budgets and transactions, today's responsibilities for restaurant CFOs often include finding ways to streamline operations, managing risk and ensuring regulatory compliance, and more, requiring them to wear many hats and have a well-rounded knowledge of all facets of the business.

Between commodity fluctuations, new minimum wage requirements and regulations around menu labeling, it's important that CFOs have a firm grasp on external pressures and the potential impact of these pressures on their business. Planning ahead is also important, as CFOs must be able to anticipate challenges and work with other departments to prioritize where to allocate capital based on key business objectives — a job that has historically fallen to the CEO or board.

Increased collaboration between the CFO and other department C-level personnel is needed to make management decisions; conferring with legal teams on compliance issues; consulting with IT managers on POS systems and cybersecurity; and

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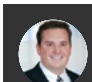
CFO ROLE

coordinating with the marketing team to plan public relations initiatives. In some smaller restaurant groups, CFOs are playing these roles themselves, and can often be found negotiating leases, making recommendations on how to implement the latest technology systems and serving as an important legal adviser. Without being a key collaborator and having a thorough understanding of all operations, CFOs may not be as effective in executing against the overall business' vision.

As my colleague Alexis Becker recently discussed with *QSR Magazine,* issues concerning CFOs increasingly go beyond the numbers and the books. These professionals must be able to make wide-ranging decisions quickly. When considering whether or not to go public, for example, the CFO is responsible for assessing the current state of the business, as well as understanding overall market conditions and determining the best course of action.

Benchmarking against peers is a crucial element of the modern CFOs' responsibilities, informing strategic decisions, ranging from marketing tactics to growth plans — including when and where is a good time to open and close stores. Oftentimes, smaller or independent concepts don't realize the benchmarking tools that are available, but a restaurant's ability to gauge how its results compare to its peers plays a large factor in planning, decision making and ultimately, success.



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TAX PLANNING IN AN ENVIRONMENT OF UNKNOWNS

By Jeff Tubaugh

As we approach the end of 2015, it's time to consider tax-saving opportunities for your business.

While we're still waiting on Congress to decide whether to extend or modify certain beneficial tax provisions for restaurants that expired in 2014 (e.g., enhanced Section 179 expensing provisions, 15-year lives for depreciating restaurant buildings and improvements, bonus depreciation, Work Opportunity Tax Credit), there are some moves you can make before the year draws to a close.

COST SEGREGATION

If you constructed or purchased any buildings or leasehold improvements during 2015 or in a recent year, a cost segregation study should be on your short-list of projects to complete in the near future. Cost segregation is a process of breaking down a building or leasehold improvements to identify portions of the construction that can be taken over a shorter five year tax life for restaurant depreciation purposes. The improvements made often contain items that are obvious to categorize under this shorter life, but other larger items are frequently overlooked. These studies require a professional to run calculations and properly document a report that will stand up to IRS audit.

REPAIRS & MAINTENANCE VERSUS CAPITALIZE

Regulations were recently issued that help to evaluate whether an expenditure should be expensed as a repair or capitalized and depreciated over a period of time. The tax

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TAX PLANNING

benefits that portions of these regulations bring to restaurants should not be overlooked.

While the definition of repair itself has not changed (keeping something in normal operating condition), the regulations offer a change in the evaluation process to allow certain situations where large expenditures for replacement assets could still be expensed as a repair. For example, if you have 4 HVAC units on top of your restaurant and one of them stops working, you can expense the replacement HVAC unit, assuming you replace the old unit with a similar new one (similar output and efficiency). In the past, companies would look at the cost of the replacement and capitalize it, but the new rules offer a different approach to evaluating a repair to a "unit of property" or system, instead of just looking at the cost. Prior to year end, an evaluation of repair versus capitalized items should be done to make sure you are taking advantage of all tax deductions available. One important note: Just because you capitalize an item for GAAP purposes does not mean that you have to also capitalize it for tax purposes. Companies do have the opportunity to retroactively benefit from these new rules by filing a Form 3115, Change in Accounting Method, after calculating the remaining depreciation to be taken on any capitalized assets that should have been expensed as a repair in prior years under these new rules.

CAPITALIZATION POLICIES

As we approach year end, it is also a good time to take a look at your capitalization policy for the coming year to make sure you don't miss out on any immediate deductions. The new regulations provide certain "safe harbor" dollar amounts for these policies depending on whether you have a financial statement audit or not. If you have opened several new restaurants during the year that caused the size of your company to grow substantially, consider reevaluating the threshold for when you capitalize assets versus expense them. One common error we find is that not everyone involved in the process of determining whether to capitalize or expense knows the details of their own policy, or they do not apply it correctly.

BDO's Selections blog and @BDORestaurant Twitter feed

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The most common error is using the total invoice cost against the capitalization policy instead of applying it on a per-item basis. For example, if an invoice for four computers is $2,000 and the capitalization policy is $1,000, the correct application of the policy would be to expense the $2,000 because each computer ($500 each) is below the policy threshold.

WORK OPPORTUNITY TAX CREDITS ("WOTC")

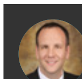
While we are still waiting for this credit to be extended to include new hires in 2015, industry observers believe that the extension will happen soon. This federal tax credit benefits companies that hire certain candidates from targeted groups that face challenges in finding employment. This credit requires outside assistance in qualifying candidates and calculating the credits, but the benefits often outweigh this additional cost.

RETIREMENT PLANS / INCENTIVE PLANS

January 1 is an ideal time to implement new retirement and incentive plans as the new year kicks off. As small restaurant companies continue to grow, they hit a point where they want to start rewarding and incentivizing their employees and key executives with the hope of boosting morale and staying competitive. For more information on retirement and incentive planning, flip to our article on page 6.

OTHER ITEMS TO CONSIDER

- **Treatment of Gift Cards** – If you are not using an IRS-approved method for gift cards (cash basis, 1-year deferral or 2-year deferral), consider the impact of converting to an approved method.
- **Prepaid Expenses** – If you are an accrual basis taxpayer, you can still use the cash basis for certain prepaid expenses. Making this change for 2015 could lead to additional tax deductions.
- **Tenant Improvement Allowances** – If a company meets the qualifications, these can be excluded from taxable income.
- **Empowerment Zone ("EZ") Tax Credit** – Assuming this credit is extended past 2014, consider claiming federal EZ tax credits for employees that both live and work in HUD-designated zones.
- **FICA Tip Credit for Delivery Drivers** – The FICA credit is typically used for full-service restaurants who have tipped employees, but restaurants that deliver and collect tips for their delivery personnel can qualify for the FICA Tip Credit as well.



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CROWDFUNDING FOR RESTAURANTS

By Dana Zukofsky

As the number of restaurants continues to grow, so does the number of different ways restaurants get funded.

We are all likely familiar with the traditional methods such as banks, private equity, IPO and friends & family, but in recent years, restaurants have begun exploring a new way to raise capital: crowdfunding.

Using the crowdfunding model for restaurants — be it for expansions, new projects, or simply to get off the ground — serves a dual purpose. First, it allows restaurant owners, or entrepreneurs looking to break into the restaurant business to effectively raise capital, which can be hard to come by. It also helps to promote the business among a loyal customer base before a project or business is even launched.

How can donors, on the other hand, benefit from contributing to a crowdfunding campaign for restaurants?

There are three main drivers behind why an investor would participate in crowdfunding: rewards, equity (or investment), or to provide debt to the restaurant and expect a payback based on a pre-determined interest calculation.

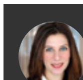
Reward-based crowdfunding gives investors an opportunity to receive an incentive for their contribution. For example, if you donate $50 to a project, you might receive a coffee mug or a gift certificate.

Equity-based crowdfunding allows investors to become true stakeholders of a restaurant. These investors will become partners in the business and share in the profits/losses. Having an equity position in the company also allows investors to sell the investment at a later time, hopefully for a profit.

Debt-based crowdfunding allows investors to make loans to restaurants. In these scenarios, debtors come to the table with capital and a pre-determined interest rate, and the business can decide whether or not they are interested in taking the money from that party.

There are a number of platforms that restaurants can use to develop a crowdfunding campaign. For instance, well-known platforms Kickstarter and IndieGoGo are global crowd-sourced fundraising sites that help organizations collect funding and provide donors with thank-you gifts. A newer crowdfunding platform, EquityEats, is geared toward restaurants specifically. EquityEats also differentiates itself because investors receive an equity stake alongside typical investment-based perks.

In all crowdfunding situations, it is very important that the restaurant receiving the funding has legal counsel and ensures that all documents are clear to the investors in order to avoid any confusion as to the investors' rights.



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INTERNAL CONTROLS FOR RESTAURANTS

By Giselle El Biri

Regardless of an entity's size, geographic location and complexity, the ability to manage operational, financial and compliance risk is a key ingredient to success.

Effective oversight and process controls are essential to managing this risk and mitigating the negative impacts of fraud, unauthorized transactions and other violations of company policies and procedures. Below are some basic internal controls that even the smallest organization should implement to help prevent and identify high-risk behaviors.

CASH

Who is closing the restaurant each day and reconciling the night sales? Who is opening and making the morning deposit? Theft can occur when the same manager counts the drawer at night and makes the deposit the next day — quietly siphoning off cash. Restaurants should reconcile their daily deposit reports and compare these reports to both what is deposited in the bank and reports from the point of sale. They should also perform monthly bank reconciliations timely and without fail, and the person preparing bank reconciliations should not be the individual making deposits in the bank. Finally, restaurants should limit the number of employees with the authority to sign checks.

PAYROLL

A common form of embezzlement involves a CFO, human resources manager or other payroll employee fabricating a fictitious employee, generating fraudulent payroll checks. To prevent this, restaurants should carefully consider the role of each employee and match access to the payroll system to their responsibility. Different responsibilities (setting up new employees, maintaining the system and generating checks) should be segregated among employees, and payroll registers should be reviewed before and after they are submitted to processing.

SOFTWARE RIGHTS

System administrator rights should be limited to an employee independent of the financial statement/accounting cycle, as employees with full system rights could override any segregation of duties in place. Management should also consider an annual review of each individual's access rights to ensure that their rights continue to fit their job responsibilities.

ACCOUNTS PAYABLE

Similar to payroll fraud, employees in the accounts payable function can set up new vendors, enter invoices and produce checks — and by extension, create fictitious vendors and misappropriate cash. Responsibilities should be divided among multiple employees wherever possible to reduce this risk.

FINANCIAL STATEMENT REVIEW

Many restaurant owners are focused on their income statements and pay little attention to their balance sheets. However, insufficient review of the balance sheet often leads to unexpected adjustments, which can affect the income statement and skew operational performance. To produce accurate financial information to facilitate better decision-making, restaurants should consider:

- Analyzing, reviewing and reconciling all accounts (specifically balance sheets) to the general ledger on a monthly and annual basis.
- Assessing the monthly reporting package, including documenting and signing off on all manual journal entry reviews by both preparer and reviewer.
- Implementing a balance sheet log that assigns responsibility for updates to one employee and reviewing entries to another.

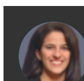
STORE MONITORING

Each location should be held accountable for operational and financial performance. The general manager, on a regular basis:

- Review payroll prior to processing. Do labor percentages look reasonable?
- Review and approve all store invoices. Is the store overpaying vendors? Is someone assigned to review pricing?
- Review and approve daily sales reports.
- Review inventory for completeness and accuracy. Does the store have a lot of waste? Are food costs too high?
- Ensure compliance with policies and procedures for human resource functions.
- Review the results of store performance for accuracy.

Once the store manager completes the review and approval process, the restaurant should send a financial package to the corporate office for another level of review.

Although proper segregation may not always be possible in smaller organizations, and companies cannot completely eliminate incidents of fraud, there are ways for restaurants to meaningfully reduce their risks. Formal documentation of all policies and procedures, as well as employee training, are simple yet important steps restaurant executives can take to reduce their exposure and protect their businesses.



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RETIREMENT AND INCENTIVE PLANS — WHERE DO YOU START?

By Jeff Tubaugh and Carl Toppin

When young restaurant companies begin growing, many of them start evaluating retirement and incentive plans to help reduce turnover, incentivize key employees and attract new talent.

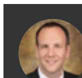
The challenge is knowing where to start. While the tax impact of these plans is a big factor, the initial key questions are: "Who do I want to benefit from this plan?" and "How do I want to reward and incentivize them?"

A bonus plan is structured to incentivize the achievement of long-term or short-term goals. A company employing a bonus structure would issue payroll bonuses to employees based on pre-established goals and performance metrics. These plans may be broad-based or available to only a few key employees. At the end of each performance period, management evaluates the extent to which the performance goals were satisfied and the payout amounts.

For restaurants evaluating company-wide retirement savings plans, 401(k) plans are among the most popular to implement. Employees can defer a portion of their salary into a 401(k) retirement account, and their employer may match the employees' deferrals for additional savings. The employer also has the option of depositing funds into employee accounts without them deferring funds of their own. The benefits of this type of plan are that all employees could be eligible to participate, and company contributions help contribute to employee goodwill and loyalty. 401(k) plans also have favorable tax consequences to both employee and employer — taxation on the employees is generally delayed until distribution, while the employer may claim deductions for their contributions. However, 401(k) plans also carry significant administrative costs for regulatory compliance related to trust holding and investing the participants' accounts. Notably, the employer may impose stringent eligibility requirements on plan participation (such as requiring employees to complete a year of service before entering the plan) in order to minimize the administrative burden associated with managing the accounts of short-term employees. Also, highly compensated employees could potentially be limited on their deferrals and employer contributions, depending on the participation and contribution levels by other employees.

A restaurant may also want to consider specialized incentives for key executives, such as nonqualified deferred compensation plans or equity incentive plans. These plans may be structured as long-term incentives, contain vesting conditions designed to retain and motivate employees, and settle in cash or equity (if the owners are willing to share their equity interests). Administrative costs for such plans, including annual valuations for equity plans and penalties leveraged on employees who do not comply with the appropriate regulations, can be high. Unlike 401(k) plans, the employer's tax deductions for contributions to nonqualified deferred compensation plans are delayed until the employees claim the benefits as part of their income. Further, the deferred amounts (including the employees' own salary deferrals) may be set aside in a trust that is subject to the employer's creditors in the event of its insolvency. Potentially worse, plans may be funded on a "pay-as-you-go" basis, and employees have no guarantee that the restaurant will be able to make payments when amounts become due.

Deciding to implement an incentive or retirement plan may be an easy decision. But it's only the beginning of a long process requiring companies to determine what plan makes the most sense for their organization, what goals they hope to achieve, and how they will successfully implement the plan.



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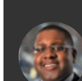

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COACHING RESTAURANT OWNERS ON SUCCESSION PLANNING

By Dr. Stacy Feiner

Proactive succession planning is fundamental to owning a successful restaurant business.

The term *succession planning* is a term used by many industry experts, but refers to very different concepts: leadership transitions, estate & tax planning, "key man" insurance policies, strategic business planning, legal agreements and financial planning, to name a few. It's important for businesses to develop a succession planning strategy that unites each of these elements to ensure that decisions are perfectly aligned to achieve leadership goals.

WIND IT UP:

As restaurant leaders begin to think about exiting and transitioning the business to new leadership, they should be winding up — not winding down. Restaurant owners should focus on positioning their businesses for long-term success before the transition occurs, in addition to identifying ways to increase their companies' value while they are still in the driver's seat. This process is a strategic one, requiring an emotional, physical and capital investment. This long-term transition strategy is anything but business as usual.

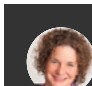
Just as if a restaurant owner were to roll out a new software system, launch a new product, or build a new plant, they would need to make a capital investment and add new resources to ensure that these desired expectations are achieved throughout the transition period. Planning is the best way to ensure the business owner's desired ROI is baked in to their succession options.

BUILD BENCH STRENGTH:

A restaurant's current business is the wealth engine for the future. It must be protected first, and deliberately grown second. With this in mind, succession planning is about more than just who succeeds the current restaurant owners — it addresses every other position in the company. Developing employees for new roles as the company grows makes the company agile, flexible and adaptive; the very traits required for growth and change. To do this, restaurant owners must know their talent as well as they know their numbers. In fact, numbers are lagging indicators of performance. If restaurant owners want to improve their bottom line, they should turn their attention to their people, developing the know-how, intelligence and processes to attract the right talent, provide them the tools they need to be productive, and advance them into new roles. Building a sound talent management system can help leaders obtain a working knowledge of talent resources across the enterprise. Additionally, this approach helps leaders create an environment that fosters employee engagement, encourages people to do their best work and prepares the workforce to handle challenges.

Succession planning is a much deeper, more nuanced process than it might appear at first blush. That's why restaurant owners need to enlist a team of both internal and external resources to ensure that no aspect of the plan goes unaddressed.

Don't go at it alone. Use the transition as an opportunity to ask yourself: How will my success pave the path to future prosperity?



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Additionally, BDO organizes roundtables, webinars, and conferences for finance and accounting professionals in the restaurant industry. Our Restaurant CFO Bootcamp® is regularly attended by top restaurant executives including CEOs, CFOs, and controllers, bringing together a variety of speakers and thought leaders to discuss financial management issues unique to the industry. Please visit www.bdo.com for upcoming events and webinars.

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