

# The MFAC Report

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## An Open Letter to Our Clients and Friends In the Wake of Madoff

January 26, 2009

Dear Clients and Friends:

I'm writing this letter with two purposes in mind. I want to reiterate how we operate and I want to provide you with as much assurance as possible that your assets are safe in our care.

First, let me say that on our investment platform, our clients have **ABSOLUTELY NO EXPOSURE** to the alleged fraud perpetrated by Bernard Madoff and his investment company. It is alleged that he collected money to invest on behalf of clients, and that he concocted false statements which showed that the investments performed very well, and he used new clients' money to pay returns and withdrawals to existing clients. By Mr. Madoff's own admission, he cost investors approximately \$50 billion. If this was done it is a classic Ponzi scheme and is only unique in its magnitude.

This is how our clients are protected. We currently use Charles Schwab & Company as our primary custodian. It is the custodian's responsibility to retain and keep our clients' funds and assets safe. You executed a Limited Power of Attorney that grants us very restrictive powers over your accounts. These powers are: To make trades in the account; to receive copies of trade documents, monthly statements and tax documents; and to deduct our fees directly from the account, in accordance with invoices you receive beforehand. By far the most important protection that you have is that you receive monthly statements and trade documents directly from the custodian. Many of you have said to me and my staff that you wish that you didn't have to receive so much paperwork from the custodian, but they are sent by the custodian **for your protection**. Our business model is quite different from that of the Madoff structure, where he managed the investments, priced them, and had custody over them.

Another very important aspect of the protection that our clients have is that we generally utilize mutual funds and ETFs in our clients' portfolios and thus they are liquid. In situations where we utilize separate account managers, we require that they custody our clients' assets with an independent custodian of our choice. What protection does this provide? The assets in the portfolios are priced minute-by-minute (when stock exchanges are open), or in the case of mutual funds, no less often than once daily. **We have no input on investment pricing.**

Additionally, all of our clients' accounts are independently owned by, and titled, in their names. **We never comingle** the assets. Yet another protection comes in the way of insurance. Each client's account is insured by the Securities Investor Protection Corporation (SIPC) to a total of \$500,000. Schwab carries very substantial additional insurance for each account with private insurers. Our clients have one of the most comprehensive insurance protection plans available. Remember, this insurance does not protect against market declines, but it does protect against theft of securities and related fraudulent transactions.

I want to mention one other point at this time. Philosophically I have never been a fan of hedge funds. They are supposed to protect investors but, in my experience, I have noted that too many of them use leverage too aggressively and they charge, in my opinion, egregiously high fees when you consider their performance (or lack thereof). It is no coincidence that we are observing the dissolution of hedge funds at record levels.

In some cases we are **deemed** to have custody over client funds because we sign checks for such clients. In those cases, we provide our clients with periodic "cash reports" which illustrate current balances of cash and cash equivalents in all such

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accounts. Additionally, we provide periodic schedules showing all cash receipts and all cash disbursements transactions from such clients' accounts. This provides clients with the information and the opportunity to question us whenever they would like clarification of a matter. Once a year our independent auditor (an unrelated CPA firm) performs a "surprise cash count," of every single client account in order to prove that the assets that we say are in the accounts are, indeed, in the accounts.

My accounting firm and its sister registered investment advisory firm have strived for more than 30 years to build the trust and confidence of our clients. One of the ways that we demonstrate our commitment to you is to do all that we can to ensure that your assets are protected from fraud and theft. If you are a client, please do not hesitate to let us know if you have any questions or concerns about the security of your assets. We fully recognize that we are discussing nothing less than your retirement and financial security. Absolutely no question about such issues should be considered off-limits.

Very truly yours,

Mitchell Freedman, CPA/PFS, AIF®

## Tax Notes

### Beware of CA Estimated Tax Changes for 2009

By Tom Trent, EA

While the final 2008-09 California budget didn't contain any new taxes, the legislature did play fast and loose with estimated tax requirements, shifting revenue from next year into this fiscal year. Ordinarily, estimated tax payments are made on a quarterly basis, with 25% of the total tax liability due with each payment. However, beginning with the 2009 tax year, the first two estimated tax payments (due April 15<sup>th</sup> and June 15<sup>th</sup>) will each need to be **30%** of the total tax liability and the second two payments **20%** each (due September 15<sup>th</sup> and January 15<sup>th</sup> of the following year).

Further complicating matters for higher income taxpayers are two more state changes. First, any individual with a California estimated tax or extension payment in excess of \$20,000, or a total tax liability in excess of \$80,000 in any year, must remit their tax payments **electronically**. The penalty for noncompliance without reasonable cause will be 1% of the amount paid. In order to pay electronically, you can either pay by credit card, using any of the usual methods, or pay online through the Franchise Tax Board Web Pay service (at [www.ftb.ca.gov/online/webpay](http://www.ftb.ca.gov/online/webpay)). Generally, our recommendation would be to use Web Pay, as there is a fee (usually 2.5%) for using a credit card.

While most of our clients will find the electronic payment system easy to use, we will be, of course, ready to assist anyone who needs help as part of our tax services. Our business management clients will have this task done for them as part of the comprehensive services we provide.

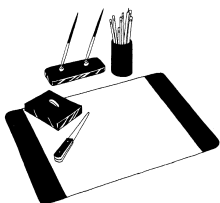
The other provision is even more troubling, but will fortunately affect fewer taxpayers. Individuals with Adjusted Gross Income (that's the amount at the bottom of page one of your Form 1040) in excess of \$1 million (\$500k for a married individual filing a separate return) must pay at least 90% of their current-year tax liability to avoid an underpayment penalty. They are not granted an exception if 110% of the prior-year liability was paid, which was the case under the old law and still applies for Federal purposes. This means that, for taxpayers affected, tax planning on a quarterly basis is now more important than ever before.



# From The Corner Office

## It Has Been Painful! But, There May Be Opportunity Out

By Mitchell Freedman, CPA/PFS, AIF®



We have been experiencing the worst financial and equity market in more than 70 years. During October 2008 the equity markets really began to tumble dramatically. As I write this column neither I nor anybody else knows for sure **where** we are in the downward spiral. It has been “officially” declared that we have been in a recession since December of 2007. Considering the disappointing corporate earnings reports and the seemingly daily announcements of massive layoffs by American companies one can be fairly certain that this will be neither a mild nor short recession. Consumers have cut back on their spending at levels not seen in at least a generation. Housing prices keep deteriorating. Banks are not lending – even to the most credit worthy borrowers. Investment portfolios, including the investments within IRAs and 401(k)s, have seen their values plummet. Interest rates on fixed income securities are at or near historic lows. So, what does one do and where does one go with respect to investments?

Before we implement investment plans with our clients we speak with them and give them illustrations about “what could happen.” What has happened is within the scope, albeit at the outer fringes, of that which we have discussed with our clients. We are now observing that some of our clients are now reevaluating whether or not they truly understood their risk tolerances. What we have learned is that the vast majority of our clients did understand their risk tolerances at the time they agreed to their asset allocation, but now that we have **seen** a “worst case scenario” some are now seeing their risk tolerances through a different filter.

During this tumultuous time we have been rebalancing investment portfolios when we believe it is appropriate to do so. We also have observed what we believe may be opportunities in the market place and are applying strategic alterations to client asset allocations and specific investments in the portfolios that we manage. We are not making wholesale changes as we believe that long term discipline and consistency will be rewarded. Nevertheless, during these times when markets are seeing the kinds of

dislocations (defined as disruptions of an established order) that we have observed that we try to take advantage of opportunities that do not occur with frequency.

This column cannot get into all of the opportunities and risks that we have observed with respect to our clients portfolios. We will be happy to discuss these matters with clients and others who may have an interest in our points of view.

In the meantime, let’s wish for a better 2009.

## Heard In The Hall

Mitch Freedman attended a Board of Directors meetings of California Jump\$tart Coalition on September 21, 2008 in Los Angeles and on December 10, 2008 attended an Executive Committee Meeting for the organization in Los Angeles. On October 23-24 he attended an AICPA Personal Financial Planning Study Group meeting in Dallas. He also attended a meeting of the AICPA/CICA PrimePlus/ElderCare Task Force November 6-7, 2008 in Toronto. On December 5<sup>th</sup> he attended a meeting of the CalCPA State PFP Committee in Los Angeles, and on December 11<sup>th</sup> he attended a CalCPA

Communications Advisory Committee Meeting in Burbank.

On September 18<sup>th</sup> Mitch participated in a CalCPA Financial Empowerment Podcast titled, “Counseling your Clients Through Fiscal Crisis” and the following day he participated in a press conference on the same topic. On October 8<sup>th</sup> Mitch appeared with Ric Romero on KABC7 discussing the stock markets. He was also interviewed for KRLA radio on October 14, 2008 regarding documents individuals should secure in the event of a fire.

*We're looking to save the tress but we need you to assist! Please notify us at [www.newsletter@mfac-bizmgt.com](mailto:www.newsletter@mfac-bizmgt.com) and we'll be happy to send you our MFAC Report via the internet. We're looking forward to hearing from you.*

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