March 1, 2003

COMMENTS - MARCH, 2003

ACCOUNTING AND AUDITING

Lapping is the theft of money received in payment of an account receivable followed by covering the theft by misappropriating payments received from other customers to cover the theft from the prior account. In effect, the person perpetrating the fraud will take money received to pay accounts A and B, and then use the payment received for account C to cover up the theft in accounts A and B, and so on. The shortage is then hidden by claiming the shortfall consists of in-transit items. Alternatively, kiting may be used, whereby a bank deposit may be made at the end of the period with money withdrawn from another bank account. The shortfall is then covered by the deposit which is made at the end of the month, but, meanwhile, the withdrawal from the other account is not reflected because the check does not clear until the following month. Over time, the stolen money will have to be replaced or the accounts written off. Otherwise the scheme will be eventually revealed either through an audit which traces month-end bank transfers and also includes confirmation of accounts receivable. However, there may be early warning signs that lapping is occurring. These might include:

- Increases in the number of billing errors.
- Reduction in the accounts receivable turnovers.
- Unusually large write-offs of receivables.
- Delays in posting customer payments.
- Inability to reconcile subsidiary accounts receivable ledgers with the general ledger.
- Complaints from customers that payments were made.

Fortunately, this type of theft can easily be prevented by the use of sound internal controls, establishment of subsidiary ledgers and controlling accounts, requirement for third party authorization for receivable write-offs and discounts, division of duties between cash handling, bank reconciliation and accounts receivable bookkeeping and recurring independent audits.

Mergers and acquisitions are a key element in helping businesses of all sizes grow rapidly. However, for a merger or acquisition to be effective, it is important a careful valuation is undertaken of the company to be acquired so the acquirer does not overpay for the business. Merger and acquisition valuation services include:

identifying an acquisition target, performing an in-depth review and analysis of the company, establishing a price for the transaction, assisting in negotiating the terms of the transaction, helping in obtaining financing and providing tax advice with respect to the structuring of the transaction. Of course, the price to be paid is fundamental to the success of the transaction, and there are basically three approaches to determining it. They are use of:

- A market approach which bases price on what others have paid for a similar business.
- An asset-based approach which bases price on the value of the equipment and real estate, and sometimes, intangibles, obtained by the acquirer.
- An income approach which bases price on how much money the buyer can earn from the acquired business.

ADMINISTRATION, SYSTEMS AND EDP

Heightened airport security is causing additional delays and concerns about damage to equipment for business travelers with laptop computers. Accordingly, Keeping Tabs, a newsletter of the "I Hate Flying Club", makes the following suggestions:

- Don't be concerned about X-ray machines, since they cannot do damage to your computer.
- Do not turn your laptop on before going through the airport security check unless asked to do so, since this could disrupt the operating system and data files.
- Minimize carrying any other hand luggage, since you would not want someone else to remove the computer from its case if it is required.
- Keep your eye on the laptop as it moves through the security check to prevent thievery.
- Make your laptop easily identifiable with brightly colored tape to enable you to watch it and to prevent other travelers from inadvertently taking it.

These are common sense ideas which can easily be implemented.

How frequently does your information management system provide sales up-dates on your firm's primary products or services to sales managers? According to an Information week study, 36% provide daily updates; 13% provide weekly data; and, 17% supply the information only on a monthly basis. At the extremes, 5% of information technology systems generate the information hourly and 8% update by the minute, while 1% provide the data only annually. We believe this type of information is crucial for sound business management. If your system fails to

provide sales data on at least a weekly basis, systems modifications or upgrades are essential.

Purchase of re-manufactured toner cartridges can reduce your printing costs by as much as 50%. However, if there is a defect in the re-manufacturing process, they can also do irreversible damage to your printer. So, before becoming overly enticed by the potential cost savings, we suggest you obtain some critical information, including the following:

- Number of times the toner cartridge has been serviced. The more frequent, the greater the likelihood of failure.
- Whether the re-manufactured cartridge contains a new photo conductor drum. They are costly and deteriorate with use.
- Whether the toner quality equals or exceeds the original equipment manufacturer's specifications.
- Whether the re-manufactured cartridge comes with a full manufacturer's guarantee against defects.

It is also a good idea to inspect re-manufactured cartridges for signs of wear which might result in failure in the middle of a print job. Despite these caveats, if you can obtain re-manufactured cartridges from a reliable office supply vendor, the savings can be substantial.

FEDERAL REGULATIONS

Travelers are cautioned they now face stiffer penalties for violating agricultural import rules. The Department of Agriculture can impose fines up to $50,000 per person (formerly $1,000) under new regulations which went into effect on October 1, 2002. The fines are imposed on travelers who bring in undeclared or intentionally concealed farm products into the United States. To avoid penalties, travelers must declare all agricultural products on Customs Declaration Form 6059B.

Recent SEC regulations have shortened the time publicly traded companies have to close their books and submit quarterly and annual reports to the Agency. The regs provide annual reports must be filed within 60 days after the close of the year (formerly 90 days) and quarterly reports be submitted within 35 days (formerly 45 days) after the end of each quarter. However, to ease the burden on registrants, the Agency has said the new requirements will be phased in over a three-year period, and they apply only to companies regulated for one year or more with a market cap of $1 million or more.

INSURANCE

U.S. companies will have to pay an average of 15.4% more to provide health

insurance for workers in 2003 than they paid in 2002, according to Hewitt Associates, a consulting firm. In 2002, the increase was only 13.7% over 2001. Although some companies will absorb the extra cost, others will pass it on to their workers. As a result, workers will pay an average 19% of the cost of their own coverage and 24% of dependent coverage out-of-pocket. The data is based on information submitted by over 2,000 U.S. health plans.

A number of life insurance companies offer policies which provide for the payment of "accelerated" or "living" benefits. Here, the insurance pays out a portion or all of the policy proceeds prior to death in the event of a particular contingency such as the incurrence of a terminal illness by the insured. Whether this type of life insurance is desirable depends on a number of factors. Typically, such a policy calls for higher premiums than ordinary life insurance which does not have the accelerated benefit provision. Furthermore, typically, when there is a premature payout of policy proceeds, the insurance company usually charges interest which will further erode any proceeds which would be available for the policy beneficiary. Finally, the receipt of an accelerated benefit could impact on the insured's eligibility for Medicaid.

The tightening of the insurance market is causing business managers to confront significant increases in insurance costs as well as shortfalls in desired coverage. How are the managers coping in this new environment? According to Munich-American Risk Partners, a leading insurance firm, here are the steps being taken to control costs:

	% of Respondents
Use larger deductibles	88%
Institute safety and engineering programs	83%
Self-insure a portion of the risk	77%
Utilize a captive insurer	35%
Risk securitization	14%

Of course, in these situations, loyalty to a particular insurer often falls by the wayside and managements seek multiple quotes from diverse insurers to determine whether a switch in insurers could lead to premium cost reduction.

LABOR RELATIONS

The sharp stock market decline and the erosion of 401(k) and other employee benefits plans associated therewith have induced numerous firms to provide financial education seminars for their employees even though they previously rejected such courses on potential liability grounds. The seminars are primarily designed to help employees gain an understanding of financial products and to give them an overview of financial planning. However, they do not provide any investment advice.

Hewitt Associates, the large consulting firm reports, based on a recent survey of

major cities, average salary increases in 2003 will be about 3.9% for salaried-exempt employees; 3.8% for salaried non-exempts; 3.8% for non-union hourly workers; and, 4.1% for executives. Although increases will depend on economic circumstances in specific locations and industries, the figures are useful as a benchmark for projected compensation adjustments. Surprisingly, employers in major cities such as Chicago, Dallas, New York and Philadelphia indicated pay increases would be slightly below the national average.

During the past five years, nearly two-thirds of companies changed CEOs, according to Gray & Christmas, a consulting firm. What is behind the frequent changes? An analysis of 476 companies reveals the changes in CEOs were brought about by:

Acquisition or merger	48.2%
Retirement	35.7%
Resignation	5.4%
Death	3.6%
Dismissal	1.8%
Miscellaneous	5.3%

The trend towards shorter executive tenure is global and is expected to lead to an even greater focus on achieving short-term business results at the expense of long-term planning.

MARKETING

A lot of salespeople and other business travelers are switching from laptops to personal digital assistants (PDAs). These devices are smaller, lighter and have the capacity to send e-mail as well as submit reports, orders and expense forms electronically. Cost is only about one-tenth of a laptop computer, so there is considerable incentive on the part of employers to have employees use PDAs instead of lugging costly laptops around on business trips. Of course, companies should also have some laptops available if a traveling employee needs greater capacity than is provided by a PDA. To determine whether PDAs may be a suitable replacement for laptop computers in your firm, make an analysis of the kinds of reports your traveling employees send back and forth, the frequency with which data is submitted and the applications for which the equipment is utilized.

Every business accumulates a number of customers which are unprofitable. In effect, they generate less revenue for your firm than the cost you incur in servicing them. It is easy to perform a customer analysis to determine who your unprofitable customers are, but getting rid of them may be a lot more difficult. Here are some suggestions which may help:

- Discontinue discounts.

- Impose charges for every service you provide (delivery, freight, etc.).

- Renegotiate the terms on which you do business with the customer.

- Suggest use of another company.

- Provide only the lowest level of possible service in the hope the customer will terminate the relationship.

- Do not renew the contract if you are a service provider.

Finally, if all else fails, be blunt and explain the account is unprofitable. In general, these procedures will help you eliminate some undesirable business and some customers will offer to accept modifications which will enable you to retain them on a profitable basis.

Here are some primary reasons for re-designing an existing web site.

- Improving overall appearance

- Updating content

- Simplifying navigation

- Adding graphics to text

- Optimizing access for search engines

MONEY, BANKING AND CREDIT

Beware of bust-out schemes! Here a new customer sets up a phony business and places several orders with an unsuspecting vendor and makes payments on a timely basis to establish credit with the vendor. After a time the customer asks for a higher credit line which is eventually used to make a large purchase. Then the customer dissolves the phony firm, sells the goods obtained from the vendor at a substantial discount, and makes a huge profit. Meanwhile the vendor can not force the customer into involuntary bankruptcy to recover the proceeds or the merchandise because the firm is out of existence. This technique has been used extensively by organized crime. Clearly, it is important a new customer be thoroughly checked out before any credit is extended to be sure you are dealing with a legitimate business. Credit experts also suggest credit application forms contain the following questions:

- What are the addresses at which your firm has been located over the past five years?

- How long has your business been operating in this area?

- Where does your company maintain its bank accounts?

- What are your firm's connections to the local community?

Companies whose responses are vague or do not check out should be investigated further and no credit should be extended unless there is substantial evidence of an ongoing, existing business.

The use of e-checks is proliferating rapidly. According to the National Automated Clearing House Association, over 200 million e-check payments were made during the first half of 2002, up 300% over the prior year. E-checks are actually electronic debits that can be transacted via the Internet, the phone or at the point of sale. In the latter case the data which is found at the bottom of regular checks is processed right at the register and results in an immediate electronic funds transfer from the customer's checking account into the seller's account. The reasons for the popularity of e-checks are, of course, the seller gets approval for the transaction at the point-of-sale and gets paid immediately, as opposed to having to wait until the check clears and, possibly, finding a check which bounces.

A common refrain of customers who are delinquent in their payments is: "I'll pay you as soon as I get paid by my customer." Unfortunately, all too often, when your customer gets paid, the funds are not remitted to you but are used for another purpose. One way around this problem is to enter into a three-way joint check agreement including your firm, your customer and the end user. Here the end-user is asked to make the check payable to your firm as well as to your customer. This type of arrangement can be highly effective in assuring you are paid before other creditors, but you should obtain legal advice first to be sure such agreements are legal in the jurisdictions of the parties; to be sure they do not conflict with other existing contracts, and to be sure they are otherwise enforceable.

PENSION AND ESTATE PLANNING

The IRS has extended the period during which prototype and other pre-approved pension plans have to be amended to reflect a series of six pension law revisions going back to the mid 1990s and to remain tax qualified, to September 30, 2003. Previously, it had stated these so-called GUST amendments had to be made by December 31, 2002. Incidentally, the due date for amending individually designed plans remains the later of February 28, 2002, or the end of the 2001 plan year.

The IRS says pay-backs of overpaid pension plan benefits can be deducted. In the particular situation, a retiree took a lump-sum distribution from the employer's pension plan and paid tax on it. In the following year, the plan realized it had miscalculated the payment, and the retiree paid back the excess amount received. The IRS says the retiree is entitled to take a tax deduction with respect to the excess amount in the year it was repaid, because he had paid tax on it. If the amount of the deduction is $3,000 or less it is to be taken as a miscellaneous itemized deduction which is deductible to the extent it exceeds 2% of adjusted gross income. But if it is greater than $3,000, it is allowed in the year of repayment or in the year in which the distribution was taxed, whichever is more

favorable for the taxpayer, and the 2% offset does not apply.

A number of changes with respect to pension plan regulations go into effect in 2003. Here, briefly, are the rules:

- The maximum salary deferral to 401(k), 403(b) and eligible 457 plans rises to $12,000 from $11,000.

- Catch-up contributions for workers who have attained age 50 and who participate in 401(k), 403(b) or 457 plans increase to $2,000 from $1,000.

- Maximum annual benefit limits for defined benefit plans for plan years ending in 2003 are unchanged at $160,000, and maximum annual addition limits for defined contribution plans also remain unchanged at $40,000.

- Maximum compensation which may be used to determine benefits and contributions for plan years beginning in 2003 remain at $200,000.

- The dollar limit for classifying key employees who are officers in a top heavy plan remains at $130,000.

- The dollar amount for determining the maximum ESOP account balance subject to a 5-year distribution period is increased to $810,000 from $800,000 but the dollar threshold for determining a lengthened 5-year distribution period for ESOPS remains at $160,000.

- The limitation for salary deferrals to SIMPLE retirement accounts for calendar year 2003 increases to $8,000 from $7,000.

- The catch-up contribution limit to a SIMPLE plan for individuals aged 50 or over increases to $1,000 from $500.

- The compensation threshold which triggers a SEP contribution for an employee is unchanged at $450, and the compensation threshold for determining a "control employee" who is ineligible for certain tax-free fringe benefits is unchanged at $80,000.

PERSONAL FINANCIAL PLANNING

Identity theft is being practiced in an increasing number of ways, and people must be alert or they could be victimized by this fraud. Some common examples include:

- Credit card theft schemes designed to reveal your credit card number.

- Phone or utility schemes in which bogus invoices are sent to utility customers.

- Bank theft schemes in which the victim is induced to turn over account and PIN numbers.

- Telemarketing schemes in which the caller offers to take people off a calling list if they turn over their credit card number.

Other schemes offer loans and scholarships, or promise to make people eligible for government benefits. People who are victims of identity theft can now speed the process of clearing their name by filing a single standard form which is used to alert banks, stores, creditors and others of the problem. Copies may be obtained by calling (877) 438-4338.

How long should you keep your bank records? According to the Federal Deposit Insurance Corporation, the following record retention is recommended:

<u>Canceled checks</u> with no long-term tax significance can be destroyed after one year, but those which support your tax returns, such as charitable contributions, should be retained for seven years.

<u>Deposits, ATM, credit card and debit card receipts</u> until the item appears on your statement and you have checked the information for accuracy.

<u>Credit card and bank account statements</u> with no long-term or tax significance should be kept about one year, but the others should be kept for seven years.

<u>Credit card agreements and contracts</u> should be retained as long as the account is active in the event disputes arise.

<u>Documents supporting the purchase and sale of stocks, bonds and other investments</u> should be retained as long as the investment is owned plus seven years.

The Agency also cautions any documents containing a social security number, bank account number or other personal financial information should be shredded before it is discarded to avoid becoming the victim of identity theft.

The IRS has warned taxpayers to be skeptical of advertising claims that donating a car to charity can produce greater tax savings than what would be realized from its sale, and it warns no deduction will be allowed if the arrangement is a scam designed to inflate the value of a donated vehicle. The Agency also indicated a professionally managed donation campaign where an agent of the charitable organization advertises for donations, arranges for the pickup of vehicles, provides paperwork for the donor sells the car and gives the proceeds to the charity which gives a percentage of the proceeds to the agent as a fee would not result in denial of the charitable deduction so long as it is clear the donation is made to the charity rather than the agent, and as long as the charity retains sufficient control over the agent. This would also be the case if a car dealership acted as an agent for a charity in the same capacity. To claim a charitable contribution deduction, the donor has to be able to prove the fair market value of the donated vehicle and obtain substantiation from the charity. The fair market value can be approximated from the car's "Blue Book" value, but the amount should not be given as the fair market value since it has to be modified to reflect the condition of the vehicle, according to the IRS. The Agency also requires for cars valued at $250 or more, the donor must obtain a "thank you" letter or other written acknowledgment, including a description of the vehicle from the charity or its agent. For cars valued at over $5,000, a qualified appraisal, which is obtained from an independent appraiser who is paid for by the donor, is required. The IRS is monitoring this area closely, because there have been widespread abuses.

REAL ESTATE

Under the Internal Revenue Code, to exclude $250,000 of gain ($500,000 for certain married taxpayers) on the disposition of a home, a taxpayer must own and occupy the property as a principal residence for two of the five years immediately preceding the sale. But the ownership and occupancy need not be concurrent. Recently, the IRS issued some proposed regulations to clarify how these rules work in certain situations. For example, a taxpayer is considered to have owned and used a principal residence during the time his or her deceased spouse used the home as a principal residence as long as on the day the home is sold, the taxpayer's spouse is deceased and the taxpayer has not remarried. The Agency also says divorced spouses can also benefit from the ownership and use periods of former spouses to satisfy the exclusion requirements. Furthermore, although a taxpayer can generally claim only one exclusion every two years, taxpayers who dispose of more than one residence in that period or who otherwise fail to satisfy the requirements due to health problems or a job change, may, nevertheless qualify for a reduced exclusion amount. It is important for homeowners with unusual situations to obtain professional tax advice before making a property disposition so tax benefits can be maximized.

Shopping mall owners and management companies should be aware if, because of bankruptcy (K Mart for example) or for some other reason, the anchor store terminates its lease, the value of the entire shopping mall will be substantially diminished. Therefore, it is important, as soon as the landlord or management company becomes aware a lease will not be renewed, data be gathered to support a revaluation of the property by the tax assessor's office to give effect to the change in value and obtain property tax relief. Information which would be useful includes letters of intent from the anchor store, listing of co-tenancy leases which permit the tenant to break the lease if the anchor store leaves, letters of termination from other tenants, ads for a new anchor store and financial comparisons with other shopping centers in the area which have faced similar problems, as well as supportive calculations reflecting the current worth of the center based on the diminished future revenue flow.

TAXATION

The IRS is cracking down harder on abusive tax shelter promoters and participants.

New regulations: (1) redefine reportable transactions so they are categorized in one of six types of transactions; (2) require organizers and sellers to prepare, maintain and furnish lists of persons in potentially abusive tax shelters, and (3) require the lists to be maintained for ten years following the date on which the material advisor last made a statement as to the potential tax consequences which may result from the transaction. Separately, the Agency has also identified a type of reinsurance transaction being used by taxpayers to shift income to related companies set up as foreign insurers subject to little or no Federal income tax as an abusive tax shelter.

IRS overpayment and underpayment interest rates fell 1% on January 1st. The rates applicable to the first quarter of 2003 are 5% for individual and 4% for corporate overpayments of tax (2 1/2% for the excess of corporate overpayments over $10,000), and 5% on individual and corporate under payments. The interest rate on corporate under payments over $100,000 is 7%. These are the lowest interest rates since 1975.

Lax IRS enforcement of tax compliance and collection is raising serious concern our voluntary tax system may be eroding due to an epidemic of cheating, according to the Government Accounting Office. The concern is reinforced by results of a recent survey in which 24% of taxpayers who were questioned thought a "reasonable" amount of tax cheating was acceptable. IRS audit statistics show the number of face-to-face audits of tax returns last year was lower at all income levels than in 2000. For example, there were only 50,827 such audits of returns of individuals making over $100,000. The IRS Commissioner has acknowledged the situation and in a report to the Agency's Oversight Board, indicated the tax cheats are winning. In light of these revelations, the IRS is revising its audit strategy to focus on key areas of non-compliance, including offshore credit card users, high risk and high income taxpayers, abusive tax schemes and promoter investigations, high income non-filers, unreported income and the National Research Program compliance study involving 50,000 randomly selected tax returns. The IRS has pledged all of its additional resources will be devoted to this effort.