May 1, 2002

COMMENTS - MAY, 2002

ADMINISTRATION, SYSTEMS AND EDP

Most companies that utilize electronic data systems are aware of the need for disaster planning to assure their business is not disrupted by a natural disaster, an accident or a deliberate act of destruction. For disaster planning to be effective, businesses must: (1) assess their loss exposure; (2) devise strategies for dealing with general risks and information technology risks and (3) prepare a disaster recovery plan. Unfortunately, even among companies which have done careful disaster planning, there are often major gaps. For example, frequently overlooked is the readiness of key suppliers who are vital to business continuation. In effect, it is necessary to cast a wider shadow and to determine whether those on whom your business relies have also taken necessary precautions. This is an area where an independent review may prove beneficial in identifying and plugging gaps in your disaster plan.

LABOR RELATIONS

What are the underlying trends in executive compensation paid by public companies? A 2001 survey by Clark/Bardes Consulting, a compensation consulting firm reached the following conclusions:

- Non-qualified deferred compensation plans were being utilized at 86% of employers.
- Supplemental executive retirement plan usage was unchanged compared to prior years.
- The number of firms allowing executives to defer part of their base salary rose to 87%.
- An increasing number of firms (83%) permit executives to defer all or part of their incentive pay.
- 95% of respondents with 401(k) plans make matching contributions to the plan.
- 36% of respondents allow executives to defer long-term incentive compensation in non-qualified deferred compensation plans.
- Percentage of firms permitting stock option gains (12%) and restricted stock (16%) to be placed in a non-qualified deferred comp plan was unchanged.
- 57% of companies provided corporate financial planning benefits for their executives and 80% of those eligible used them.
- One-half of highly compensated executives deferred between 6% and

8% of compensation in 2001.

During the first half of 2001, employee benefit costs had risen 27.1% to $5.63 per hour, according to the Bureau of Labor Statistics. As a result, employers have been scrambling for ways to bring their expenditures under control. The primary culprit is prescription drugs which increased 18.8 percent during the past year and are expected to increase another 20% in 2002. Various containment measures employers are putting in place include:

- Higher co-payments
- Three-tier prescription drug plans for generic drugs, brand name drugs on an approved list (formular drugs) and brand name non-formulary drugs.
- Replacement of set co-payments for all drugs with higher co-payments for optional medications and lower ones for drugs needed for chronic conditions.
- Use of higher deductibles.
- Requiring employees to pay a greater portion of medical insurance premiums. Currently most employer require employees to pay about one-third of the cost of family health care coverage.
- Utilizing the Internet to administer benefits and distribute health care information to lower costs.
- Promotion of employee wellness programs through smoking cessation and weight loss as well as other programs.
- Substitution of employer health insurance premium payments for a reduction in pay raises.

Incidentally, total family health benefits costs, which already exceed $4,000 per employee per year, are also expected to rise at rates exceeding 10% next year. This adds pressure on employers to review health plan utilization rates and implement strategies for curtailing outlay.

PENSION AND ESTATE PLANNING

Over the past decade, nursing home costs have risen at an annual rate of 5%, and a similar increase is projected for 2002 and subsequent years. It's estimated that the average cost of room and board is now $136 per day, and the cost of necessities such as medications and therapy needed by residents is not included in the basic charge. While Medicaid paid for about 65% of total nursing home payments, Medicare only covered about 9%. In effect, unless one is almost destitute, the costs of long-term nursing home care will have to be met through the exhaustion of savings. For those who are still in their working years, this suggests that wealth accumulation through long-range retirement planning is essential, and that alternate care options need to be explored.

For 2001, couples who are covered by retirement plans can deduct up to $2,000 of their adjusted gross income if their adjusted gross income does not exceed $53,000, and this deduction phases out as adjusted gross income rises to $63,000.

The same situation applies to singles who actively participate in the plan except the IRA deduction phase-out occurs when adjusted gross income rises from $33,000 to $43,000. However, for 2002, the maximum IRA deduction rises to $3,000 and the phase-out zones are increased by $1,000 at either end. Also, when only one spouse is in a plan, the pay-in limit is $150,000 of adjusted gross and it phases out as it rises to $160,000. For singles, the pay-in cap rises to $95,000 and is phased out as adjusted gross income rises to $110,000. The same rules apply with respect to pay-ins to Roth IRAs; however, to switch a regular IRA to a Roth IRA, adjusted gross income must be $100,000 or less. The rules governing IRAs and other retirement planning vehicles have become increasingly complex since enactment of the recent tax law. Virtually everyone now needs some professional tax advice in this area.

Why are small businesses likely to have fewer employee benefit plans than large firms? Primary reasons given by small business owners are uncertainty about future revenue and worker preference for higher wages or other benefits rather than a pension plan. The age of workers may also be a significant factor underlying the sparsity of pension plans in small firms. A recent survey by Dun & Bradstreet concludes that only 17% of small businesses with 25 or fewer employees offer them retirement benefits. Of these, about one-third offered individual retirement accounts or a Keogh plan; another third offered a 401(k) plan; 17% offered a qualified pension plan, and the remainder offered a variety of benefits such as a personal investment portfolio, retiree health insurance and whole life insurance. The data was based on responses from 540 owners and key executives of small firms.

PERSONAL FINANCIAL PLANNING

If you are establishing a home office, shopping for the needed furniture and equipment can be a major undertaking. But here is a way to limit your choices and also focus in on the best and most economical items for your office:

- Review magazines and journals, and browse at websites which specialize in small business furniture and equipment to gain familiarity with what is available.
- Analyze the work you will be doing, the space available and your work habits to zero in on your equipment needs.
- Evaluate the need for scalability of the equipment so you can add on rather than replace if your requirements grow.
- Carefully compare costs and resist impulse buying.
- Evaluate compatibility of equipment you already own with equipment you are considering buying.
- Require demonstrations so you can evaluate ease of use, speed, noise levels, output quality and other essential factors before reaching a buying decision.
- Find out the return and exchange policy in the event your purchase is unsuitable.
- Clearly understand the warranty and the level of manufacturer and

retailer support you might obtain.

- Utilize a credit card for the payment because many cards will double the warranty period, and because the card issuer may intervene for you if a problem arises.
- Carefully read the owner's manual for maintenance tips and service recommendations.

Here's a primer for avoiding major mistakes in personal financial management:

1. If an opportunity sounds too good to be true, avoid it.
2. Always check a company's or a worker's references with the appropriate state government agency or the Better Business Bureau if the other party is unknown.
3. Walk away if you are being pressured to make a financial decision.
4. Never invest in anything you don't understand.
5. Discuss large prospective investments with family, friends and professional advisors such as your CPA before committing any funds.
6. Don't pay to obtain a prize or to be allowed to enter a contest.
7. Don't provide your credit card number to anyone unless you initiated the call.

Unfortunately, even business savvy people who know better get "carried away" when presented with a great opportunity, and make a hasty decision that they will ultimately regret.

Under the new tax law, the maximum annual contribution to education IRAs was raised to $2,000 for tax years beginning after December 31, 2001. Contributions to these accounts may be made by couples with adjusted gross income up to $190,000, and half this amount for singles. The contribution for a particular tax year may be extended to April 15th, of the following year. Furthermore, the accounts may now be used to finance both undergraduate and graduate courses at private, public or religious schools, as well as for pre-college schooling. This means they can be tapped to pay for kindergarten through 12th grade in a private or parochial school. Anyone can make a contribution to an education IRA, but the aggregate contributions cannot exceed $2,000. Also, a contribution to a state's Section 529 tuition plan won't bar the person from also making a contribution to an education IRA.

REAL ESTATE

Rising home prices and losses in the stock market have caused many renters to give up their dream of ever owning a home. But we'd like to suggest that, in spite of the setbacks, there are ways of becoming a homeowner. For example, if you have problems with the down payment, consider these options:

- Borrow from a family member. No interest loans up to $100,000 are not taxed if the funds are used as a down payment on a personal residence and the borrower's net investment income is $1,000 or less.
- Consider co-ownership with a parent. (The co-owner would be considered

engaged in a passive activity which could impede the write-off of some expenses.)

- Obtain a gift from a family member. Married individuals can make gifts up $22,000 this year without gift tax liability.

If you are unable to cover the ongoing housing costs you can consider temporarily leasing out a portion of the home to a tenant. This will enable you to obtain income as well as tax deductions beyond mortgage interest and real estate taxes for rental expenses, including insurance, repairs and depreciation. Finally, don't forget the significant tax benefit of exclusion of gain up to $250,000 from taxes ($500,000 for a couple) if the home has been used as a principal residence for at least 2 out of 5 years prior to the sale by the owner. However, note that this exclusion applies only to the portion of the home used for personal use and not to the rental portion of the house, and that any depreciation deductions taken in association with leasing out a portion of the property is subject to recapture at the time of sale.

PAYROLL TAXES

By law, the wages of students employed by a school, college or university are not subject to FICA taxes, and numerous hospitals have filed claims for refunds of payroll taxes on wages paid to their medical residents. However, not all hospitals are entitled to the FICA tax refunds. The IRS says teaching hospitals which are not part of a medical school are not eligible for the FICA tax exclusion. Such hospitals are not schools since their primary purpose is to provide care to patients.