COMMENTS - JULY, 2002

ACCOUNTING AND AUDITING

If you are planning to start a business, a major focus needs to be on the adequacy and accuracy of a record keeping system to:

- Provide information on the progress of your business.
- Let you obtain financial statements.
- Enable you to analyze the sources of revenue.
- Allow you to track expenses.
- Enable you to measure profit margins.
- Provide data for tax return preparation.

Since the IRS requires you to maintain supporting documents to determine the accuracy of the income you report and taxes you pay, you must maintain cash register tapes, bank deposit slips, receipt books, sales invoices and credit card sales slips in support of your revenue and canceled checks, cash register tape receipts, credit card sales slips, invoices, bank statements and petty cash slips to support your purchases and expenses.

Furthermore, if you acquire assets for use in your business, you must have information on when and how the asset was acquired, the purchase price, depreciation taken and eventual disposition of the asset including selling price and selling expenses.

Finally, you must consider whether to use a traditional paper record keeping system or whether you want to use computers and an electronic record keeping system for a portion of your business activity. In the latter case, the IRS requires you use a computerized system which enables you to produce sufficiently legible records to verify the entries on the business tax return and to determine the correct tax liability. In effect, the computer records will have to reconcile with your books and tax return and be sufficiently detailed to permit identification of the underlying source documents.

When we provide accounting and tax services for start-up business ventures, we place considerable emphasis on the establishment of record keeping systems which will grow with the business, which will provide relevant and reliable information for management and which will enable the firm to meet IRS record keeping requirements.

FEDERAL REGULATIONS

Congress has passed the "Victims of Terrorism Tax Relief Act of 2001" to provide income

and estate tax relief for victims of terrorist attacks on the United States, including those on Oklahoma City. Major provisions of the legislation include:

- Exemption from income tax liability generally for individuals who die of injury incurred as a result of terrorist acts which occurred on September 11, 2001, or April 19, 1995, in Oklahoma City, or from anthrax attacks occurring on or after September 11, 2001 and before January 1, 2002. Exemption is for the year of death and for certain prior taxable years ending before the taxable year in which the wounds were incurred.

- Giving estate tax relief to active members of the U.S. Armed Forces who are killed in action while serving in a combat zone or dying from wounds suffered there on the same basis as to victims of the terrorist attacks.

- Excluding employer-paid (and self-employed) death benefits from income tax, where payment is made due to the death of an employee from injuries incurred in terrorist attacks. This is effective for taxable years ending before, on or after September 11,2001.

- Giving the Treasury Department authority to postpone tax filing deadlines for up to 1 year in situations involving declared disasters, terrorism or military action occurring on or after September 11, 2001.

- Allowing 501(c)(3) charitable organizations to make payments to families of victims without having to specifically assess the need for the payments to be related to the purpose or function constituting the basis for the organization's exemption.

- Exclusion of certain qualified disaster relief payments from income tax.

- Imposition of a 40% excise tax on transactions in which structured settlement payments are sold for a lump-sum, unless the transaction is approved by a court as being in the victim's best interest and does not contravene any Federal or state statute.

- The exclusion from gross income of disability income of U.S. civilian employees attributable to a terrorist attack outside the United States, is expanded to apply to disability income received by any individual attributable to a terroristic or military action.

- Exclusion from income tax for certain death related cancellation of indebtedness applicable to discharges made after September 11, 2001, and before January 1, 2002.

INSURANCE

When most people purchase disability insurance policies, their focus is usually on the amount which will be paid out if they become disabled. Unfortunately, to avoid making a mistake, equal consideration should be given to such other factors as:

- Definition of disability since the more liberal the definition, the greater likelihood of obtaining payments.

- The elimination period, i.e., the time before benefits are paid out. Premiums can be increased or lowered by adjusting this period.

- The benefits period which determines how long a period benefits will be paid, or uses an age factor (age 65, for instance) when benefits cease.

- Cost-of-living adjustments provided. Without a COLA rider, policy pay-outs will tend to become inadequate over time.

MARKETING

Improvements in the economy are encouraging many transportation companies to increase their freight charges. Since many companies can not raise selling prices, if they do not monitor their transportation outlays, they can quickly be caught up in a profit squeeze. Here are some suggestions for controlling transportation costs:

- Request current rate tables from major carriers and carefully read the fine print to determine the rates you would actually be charged.

- If you are quoted highly competitive rates by phone, obtain the information in writing.

- Attempt to use a single carrier for most of your transportation needs and try to negotiate rate reductions. This may also increase your shipping operation efficiency.

- Utilize technology to improve load planning, in-transit monitoring of shipments and enhance efficiency and customer service.

- Try to consolidate shipments or utilize a less than truckload carrier to minimize transportation cost.

- Review shipping department procedures to determine if a system is in place for obtaining the lowest freight charges and avoiding express charges for non-priority shipments.

MONEY, BANKING AND CREDIT

Personal bankruptcies have risen 9% during the past 12 months to 1,426,000, and the trend continues upward. It's well documented many people live way beyond their means, dig themselves a deep financial hole and then look for the "easy" way out by declaring bankruptcy under Chapter 7 of the Bankruptcy Act. Chapter 7 provides for a debt discharge and is intended to provide relief for those who are so hopelessly in debt of which they will never be able to repay even a portion to creditors. However, many people mistakenly believe all of their debts are automatically absolved under Chapter 7. Not so, since the following debts are not discharged:

- Federal and state taxes owed, except those owed for more than 3 years.

- Child support payments.

- Alimony and other types of court ordered spousal support.

- Most student loans.

- Secured debt.

- Debts which were not listed on the bankruptcy petition.

- Punitive money damages in connection with willful and malicious acts against another party.

Not only do these obligations remain, but the filing for bankruptcy under Chapter 7 also stays on an individual's credit report for up to ten years, and this makes it difficult to obtain a car loan, finance the purchase of a home, obtain credit cards or get any other kind of credit. Furthermore, what creditor who was not repaid by a debtor who used Chapter 7 will ever again extend credit to the person? It's clear, declaring Chapter 7 bankruptcy not only creates severe turmoil in a person's life, but also leaves a stigma which is difficult to erase. That's why our advice, except in the most dire circumstances, is to seek other ways to meet one's obligations. These might include working out a repayment arrangement with creditors, negotiating a partial debt forgiveness, debt consolidation and rearrangement of outstanding debt to lower interest cost and enable a person to gradually liquidate debt.

PENSION AND ESTATE PLANNING

About 35% of workers under age 59 who change jobs cash out the balances in their 401(k) accounts. Not only are they hit with taxes and penalties when they pay their taxes, but they also lose the future earnings on the funds which have been taxed away and on the balance which is no longer invested. The tax cost alone, is estimated to be between $7.1 and $8.3 billion per year. Furthermore, it's estimated that each $10,000 reduction in retirement savings results in a loss of about $100,000 in funds available over the person's retirement years. The overall financial naivety of many pension plan participants is blamed for the mismanagement. One way to counteract this is to provide some professional education for retirement plan participants. According to a major financial service company, when provided with employer-sponsored retirement education and investment advice, 60% of those who would have cashed out decided to roll over the 401(k) plan into an IRA to keep their retirement savings intact.

Retirement planning is a lifelong process which must begin early in one's career. In general, those people who are successful in their retirement planning do the following:

- Take a long-term focus on building up assets through saving and careful investing.

- Engage in diversifying their retirement assets to protect them from excessive risk in the event of economic uncertainties.

- Maintain a consistent investment strategy and avoid trying to cash in on the latest stock market craze.

- Review the plan annually to determine whether financial objectives are being met, or whether modifications are desirable in light of changes in tax laws or other events.

- Build a relationship with financial and tax advisors who can provide ideas and tools for maximizing wealth and minimizing taxes.

PERSONAL FINANCIAL PLANNING

- # No doubt you have heard of identity theft. It occurs when criminals capture personal data about you such as social security numbers, birth dates, PIN numbers and bank and credit card account numbers and take on your identity to engage in fraudulent transactions which deplete assets belonging to you or cause you to become liable for transactions you did not initiate. To prevent this, people are always warned to be suspicious of offers which seem to be "too good to be true" and <u>never</u> to provide any personal information over the phone unless they initiated the call and the information requested is required in connection with the purpose of the call. You should be particularly careful about revealing your social security number, credit card numbers, account passwords and other personal information even if you initiated the call. If you become a victim you should immediately notify the police and the bank, credit card company or other entity which is being used, to report the fraud and replace the credit cards and checking accounts being used in perpetrating the identity theft. You should also be aware the Federal Trade Commission has a hotline for victims of identity theft to report crimes and obtain help on resolving problems. The number is (877) 438-4338. Alternatively, you can visit the Agency's web site at www.ftc.gov and click on "Consumer Protection" to get information and advice. By the way, speedy reporting is essential in limiting the extent of the crime, in the apprehension of perpetrators and in limiting your risk of exposure to liability.

TAXATION

- # It may be possible for taxpayers to both reduce taxes and insulate themselves from audit risk by electing to have their business taxed as an S corporation. The tax reduction comes about because when business income is reported on Schedule C of an individual return, the 15.3% self-employment taxes are paid on the entire income from the business, whereas with an S corporation, the tax is only imposed on reasonable salary paid by the corporation to its owner/employee. The audit risk is lowered, because the IRS carefully scrutinizes Schedules C and selects a significantly greater percentage of such individual returns for audit than the percentage of S corporation returns it audits.

- # There is an ongoing issue between taxpayers and the IRS about whether accrual basis taxpayers which incur expenses that straddle two years must prorate the expenses, or whether the entire expense may be deducted immediately. Now, the Court of Appeals for the 7th Circuit has ruled that a trucking company could deduct its annual payments of fees for licenses, permits and insurance premiums in the year incurred, even though the benefit of the payments covered two tax years, regardless of whether the taxpayer was on the accrual method of accounting. The ruling overturned the IRS and Tax Court's position that the expenses had to be capitalized and prorated. It reached the conclusion because the expenditures were ordinary business expenses which occur every year in the operation of the business and never extend beyond a 12 month period. The decision could simplify accounting for many businesses, and also result in a one-time deferral of tax.

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