October 8, 2001

COMMENTS - OCTOBER, 2001

ACCOUNTING AND AUDITING

For many clients, inventory is their major asset. Unfortunately inventory falsification is also a major source of accounting fraud. Therefore, when a CPA firm is engaged as auditor, a significant portion of its procedures is focused on assuring the inventory exists and is properly valued. Techniques used include observation of physical inventory counts, use of cut-off procedures to insure inventories and sales and purchases are recorded in the appropriate accounting period, assessment of internal controls which protect against inventory manipulation and analytical procedures which give assurance the inventory is fairly reflected in the financial statement. When it comes to analytical procedures, typical signs of possible inventory manipulation and fraud include:

1. More rapid increases in inventories than in sales.
2. Declining inventory turnovers.
3. Reductions in shipping costs as a percentage of inventory.
4. More rapid increases in inventory than in total assets.
5. Reduction in cost of sales as a percentage of sales.
6. Differences in the cost of goods sold between the accounting records and tax returns.

Since almost 60% of all inventory fraud is perpetrated by company employees, it is believed that concentrating the audit resources in this area is very much in the interest of the company.

ADMINISTRATION, SYSTEMS AND EDP

Do you permit employees to bring software from home and load it onto your computers?

Do you let employees download copies of unauthorized software from the web?

Do you permit employees to share computer software with co-workers?

These are common practices which can lead to serious legal and financial consequences for your firm if the software is illegally copied or used on your computer system. This is true even if you were not aware it was going on or the employees failed to realize they were engaged in an illegal act. The number of enforcement actions being brought by the Software & Information Industry Association is increasing and usually employers don't become aware they have a problem until a U.S. Marshal arrives and seeks access to your system to conduct a software audit. To avoid such consequences:

1. Establish and enforce a strict software piracy policy clearly indicating only properly licensed software may be loaded onto your company's computer system.
2. Conduct a self-audit of all existing software on your system to determine it is properly licensed and delete any unauthorized programs.
3. Consult an attorney to gain a clear understanding of your firm's legal obligations and possible liabilities with respect to unlicensed software.
4. Assign a managerial employee in your organization to approve all software which is loaded onto or copied on your information system.

The average business e-mail user receives 30 messages per day and it is not uncommon for managers to receive as many as 100 messages per day during a business promotion. Obviously, a major concern for recipients is how to handle the "incoming" e-mail while at the same time attending to their other responsibilities. Here are some suggestions:

1. Segregate incoming e-mail into pre-designated files.
2. Discard old messages and repetitive ones.
3. Keep reply messages brief and to the point.
4. Read e-mail at designated times during the day rather than when the messages arrive.
5. Only respond to the messages that request some specific action.

Incidentally, it's estimated a recipient of 100 e-mail messages per day would spend at least 4 hours per day processing the data and transmitting required replies.

FEDERAL REGULATIONS

If your are looking for a broker, you should be aware the National Association of Security Dealers (NASD) has developed a Public Disclosure Program to help investors determine whether there is any disciplinary history with regard to the individual broker or the firm. A free brochure explaining the Program is available by calling (800) 289-9999.

INSURANCE

U.S. homeowners pay approximately $1.3 billion per year in unnecessary mortgage insurance premiums by some estimates. Mortgage insurance costing an average of about $500 per year, is usually required when a home buyer makes a down payment of less than 20% on the home purchase. Frequently, even though homeowners have paid off 20% of the mortgage loan's original appraised home value or when appreciating property values decrease the loan balance to less than 80% of the home's value, homeowners continue to be charged for the insurance by the lender. If this may be your situation, we recommend you:

1. Find out from the lender whether you are being charged for private mortgage insurance.
2. Determine whether you have paid off 20% of the loan's original appraised home value, and if so, request the insurance be canceled.
3. Obtain an appraisal of the home value if property values in your area have been rising and seek cancellation of the mortgage insurance.

Do you use your van or another vehicle to car pool your own and other people's children to school or sports practice or some other recurring event? Your regular liability coverage should protect you if you cause an accident while driving the car pool, but if the car-pool driving is considered business use of your vehicle, the regular insurance might not provide coverage. Business use of the vehicle might be presumed if you receive gas money or a small fee from participants for your car-pooling services or if you provide the car-pooling as part of a home-based day-care business. Since different insurance companies have different rules, you should check with your insurer to determine whether your existing liability coverage provides adequate protection. Also, consider the adequacy of medical payments coverage which pays for injuries incurred by the driver and passengers regardless of who is at fault in an accident. Insurers, generally, recommend coverage be raised from the standard $2,000 per person to $5,000. This will increase the annual auto insurance premium by between $20 and $50 depending on where your live. It's a common mistake to engage in chauffeuring activities for your children and their friends without recognizing the activities impact on your auto insurance requirements.

LABOR RELATIONS

The average worker with children misses six to eight days of work per year because of a child-care "breakdown" such as a Nanny quitting or a baby sitter calling in sick. No wonder, back-up child care arrangements are one of the fastest growing areas of work/life initiatives among employers. Some are arranging with local child care providers in the event of an emergency while others are developing their own child care facilities. As an added incentive, the new tax law provides for a credit for up to 25% of the employer cost of building and operating a day care center for children of employees, with a ceiling of $150,000 per year. Usage of the facility cannot favor high-paid employees and at least 30% of the children attending the center must be children of employees. The legislation also provides for a 10% credit for expenses incurred in providing child care resources and referral services.

MARKETING

Businesses use a variety of pricing strategies to maximize profits, fend off competition or gain market share. For example, how should you go about raising prices?

1. Raising prices without giving customers notice is fine if you have a generic product, little competition and the increase in small.
2. Taking step (incremental) increases over set intervals is effective if you are not

sure of the impact on sales volume and profits.

3. Forewarning customers is appropriate if a large price increase is planned.
4. Coupling a price increase with a sale on the item at the old price is suitable when you want to reduce excess inventory.
5. Reducing the quantity of the item or the packaging without imposing a price increase is appropriate when a price hike is needed but competition is stiff.

Conversely, price cutting would be appropriate to:

1. Reduce excess inventories.
2. Increase market share
3. Prevent a competitor from gaining a foothold in your market.
4. Let customers benefit from declining costs.

MONEY, BANKING AND CREDIT

Are you finding invoice approval is a tedious process in your organization? Here's a way to speed up the process. Scan invoices as they are received and then e-mail the electronic copies to the purchasing, accounting and other departments that require their approval. If purchase orders, and receiving and inspection reports were also scanned, they can also be accessed electronically by the department which can approve payment of the invoice. Then the electronic data can be e-mailed to the accounting department together with the payment approval. Besides speeding up the invoice approval process, the automation of the payment process also results in establishment of an electronic record of the entire ordering, purchasing and payment transaction.

If you have FDIC insured accounts, you should be aware special rules apply when one bank is acquired by another. The problem is particularly acute when a depositor has accounts at both the acquired and acquiring institutions and together the accounts add up to over $100,000. Under the special rules, the two accounts that existed before the merger and were each insured for up to $100,000 would continue to be insured for the same amounts for up to 6 months following the merger. As a result, even though the combined balances are in excess of $100,000, the depositor would not be exposed to risk of loss during that period. The 6-month grace period also gives the depositor time to either restructure the two accounts so they are fully insured at the merged institution or to transfer excess deposits that would not be insured to another institution.

PENSION AND ESTATE PLANNING

If you have an IRA with a trustee who charges an annual custodial or administrative fee, you won't get a tax deduction unless the fee is paid out of separate funds rather than charged against the IRA account. You should request the trustee bill you directly for the fee, and make a payment using funds outside the IRA account. This will enable you to claim a miscellaneous itemized deduction for the fee. Of course, miscellaneous itemized deductions must exceed 2% of your adjusted gross income for you to obtain a tax benefit. Still, even if you can't

derive a tax benefit by paying the fee separately, you'll still benefit because the full value of your IRA will be left intact to earn tax deferred income.

PERSONAL FINANCIAL PLANNING

Do you do volunteer work for a charitable organization? In general, you may claim a charitable deduction only if you make a direct payment to a charitable organization. However, if you do volunteer work you may deduct the out-of-pocket expenses you incur in performance of that function. This might include the cost of special equipment you might be required to purchase in conjunction with the volunteer work, meals lodging and transportation expenses while performing the volunteer services, cost of uniforms you must obtain in conjunction with the volunteer work, cost of travel to and attendance at charity-sponsored conventions so long as you're officially designated as a delegate to the convention and automobile expenses such as gas and oil, parking fees and tolls incurred in performing your charitable work. Alternatively, if you do not want to maintain detailed records you may take a deduction of 14 cents per mile, plus parking costs and tolls.

REAL ESTATE

It's quite common for parents to help out children with the purchase of a home by making an interest-free loan towards the down payment. Here are the IRS rules regarding interest-free loans:

1. On loans up to $10,000 there are no adverse tax consequences and the IRS will not impose interest.
2. When a loan is for more than $10,000 and up to $100,000, the IRS will impute interest as though interest is paid on the loan. However, the interest will only be imputed to the extent to which the borrower has investment income. Thus, if the borrower has no investment income, no interest would be imputed.
3. For loans over $100,000, which are rare, the tax rules become extremely complicated and require careful analysis with one's tax advisor.

Regardless of the size of the loan, the arrangement should be formalized and be supported by a signed note setting the terms of the loan and the property should be pledged as security for the loan in accordance with local law. In some instances special arrangements may also have to be made with the mortgage lender regarding the use of the home as collateral for the parental loan.

TAXATION

Are back wages taxed for payroll tax purposes in the year in which they are paid, or are they taxed in the year for which they were paid? The issue came up recently in a case involving the Cleveland Indians baseball team. In 1994, it paid back wages which were due in1986 and 1987. The company argued the wages should be taxed for FICA and FUTA purposes with reference to the years for which they

were paid (1986 and 1987). However, the IRS argued the payroll taxes should apply based on the year in which they were actually paid (1994). The case went all the way up to the Supreme Court which held the IRS was correct, to the chagrin of the baseball team. Of course the payroll tax base had risen considerably between 1986 and 1994, with the result the team had to pay a much larger tax on the back pay award.

Use of a credit card for paying one's income tax may offer convenience, delay to the last moment payment of one's tax liability, as well as provide a reward in the form of frequent flier miles. However, remember the fee imposed for payment of taxes by credit card, it is <u>not</u> a tax deductible expense. The fee which is about 2.5% of the amount charged is to be treated as a personal expense that is non-deductible, according to the IRS National Office.