



CERTIFIED PUBLIC ACCOUNTANTS & ASSOCIATES

ACCOUNTING, BUSINESS AND TAX ADVISORS

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## Fraud Deterrence

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- There should be an organization chart showing areas of responsibility and lines of reporting.
- All functions need to be monitored through direct supervision and by the use of management reports.
- Budgets should be established and compared with actual expenditures.
- There must be adequate separation of duties to prevent incompatible functions being performed by the same individual.
- Expenditure limits must be estab-

lished at all levels so that authorization by higher management is required if limits are exceeded.

- Assets must be physically protected through registers, fences, etc. to prevent theft or loss.
- Personnel should be rotated regularly, and everyone should be required to take a vacation.

Owners of smaller companies with only one or two people in the office need to take special caution to involve themselves appropriately in all financial transactions. For example, the owner should be the first one to open the bank statement every month and the bookkeeper or accounting personnel should not be permitted to sign checks. If you are out of the office often or allow your

staff to open the mail, you may consider mailing your bank statements to your home to ensure that you are the first to open it.

An effective way for contractors to evaluate their internal control systems and to establish a system that is suitable to the size and nature of the company is to obtain an independent operational audit or an internal control review. Through one of these engagements, system weaknesses can be revealed and recommendations for implementing procedures that will enhance asset protection and management control over your business operations can be provided. Speak to a financial advisor with fraud experience to ensure that you are protected.



TODD J. LAYCOCK, CPA

## New Audit Guide Released by IRS

by Todd J. Laycock, CPA


The Internal Revenue Service randomly audits a certain number of businesses each year to ensure that taxpayers are in full compliance with tax laws and regulations. To help its auditors proficiently audit many different industries, the IRS regularly publishes and updates its audit technique guides. The audit technique guides give details and examples for what IRS agents should be searching when conducting an audit. Fortunately for the taxpayer, these guides are made available to the public so that you can know in advance for what the IRS will be looking should you be the target of an IRS audit. The IRS has recently updated its audit technique guide for the construction industry, and the updates may impact your business.

The revised guide specifically instructs IRS agents to ensure that construction companies correctly report income from long-term contracts, especially policing the exceptions to the percentage-of-completion reporting method. Agents are instructed to specifically focus on small contractors and those in the home building industry for these issues. Moreover, auditors are being instructed to look carefully for underreported income, especially in the home building industry.

Because misrepresenting your income to the IRS can carry serious penalties, we recommend that you allow a qualified tax professional assist you with developing tax planning strategies that will maximize your tax benefits.

Please contact your financial advisor for more information about this new guide and ways to reduce your risk of being audited.

# 3rd Quarter 2009 INSIDE

 **SEPs are SIMPLE, as long as you follow the rules**

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# ContractorChronicles

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## SEPs are SIMPLE, as long as you follow the rules

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by Laurie Copeland, CPA

Many employers choose to implement retirement plans to provide a benefit to their employees. If you think the rules surrounding many of the popular plan options are complex, a simplified employee pension plan may be for you. These plans offer the benefit of having a tax-deferred retirement plan for your employees without the hassles of setting up a more complex plan. They even help you save for your own retirement because you will have to be a member of the plan, as well.

Simplified employee pension plans (SEP) provide an easy method for you to make contributions to a retirement account for yourself and your employees. Instead of setting up a profit-sharing or money purchase plan with a trust, you can adopt a SEP agreement and make contributions directly to an individual retirement account (IRA) set up for yourself and each eligible employee.

Although SEP plans are designed for small businesses, any employer, regardless of number of employees, size, legal formation or annual income, may establish and maintain a SEP. The plans have requirements that must be met to ensure that they are in compliance with the Internal Revenue Code.

Despite the requirements imposed by the IRS, setting up a SEP plan is

relatively easy, especially with the help of your financial advisor. In most instances, it is a three-step process:

1. You execute a formal written agreement (such as IRS Form 5305-SEP).
2. You provide each eligible employee with a copy of the written agreement.
3. You (or each of your employees) set up a SEP-IRA for each eligible employee.

Although setting up a SEP is easy, there are still instances where taxpayers can find trouble with the IRS when dealing with these plans.

A recent IRS case involving two individuals, a husband and wife who were the only two employees for an S corporation, were in hot water due to the SEP deductions they took on their tax returns. The individuals had established the SEP, committing to make contributions for all employees over the age of 18 who had worked for the company for at least six months. Unfortunately, the deduction for the SEP was taken only on behalf of the husband in this case. The wife was also eligible and should have taken a pro rata deduction on her tax return as well. Because of this, the IRS disallowed their deduction.

Consulting with a financial advisor is, in our opinion, the best way to ensure that your SEP plan, or any tax-deferred retirement plan, is in compliance with the law and tax regulations. Call your financial advisor today to set up a plan for your employees.

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## Managing Risk Management

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by Gordon Proctor, CPA

Every day, your company faces more risks than you probably realize, which is why it is so important to have a risk management plan in place. If your first thought after reading the preceding sentence was, "well, we're current on all of our insurance premiums," keep reading.



Risk management is a process for dealing with risks that includes insurance – but not as its only component. Insurance is only one form of risk management. The essence of risk management is assessing a risk and then handling that risk; and there are only a few ways to handle any risk – avoid it, reduce it, retain it or transfer it.

The method of managing risk that you choose will depend on the type and level of risk. You must assess the probability of loss, the possible amount of loss versus the possible amount of gain and your own risk tolerance.

Avoiding risk in many cases is not a viable option. For example, if the risk is on-the-job employee injuries, you would have to prohibit employees from working to avoid the risk.

# ***“Building Profits Through Planning”***

Because this is not an option, you must attempt to reduce the risk. This is achieved by implementing and following safety regulations and procedures, training employees on various types of equipment and closely supervising jobs.

Retaining risk entails taking responsibility for the risk and paying for the loss if the risk does occur. One example of retaining risk is the bidding process. Accurate bidding reduces the risk that a job will not be profitable if you win a bid. However, if the job turns out not to be profitable after it is finished, you have retained that risk and will need to make up for the lack of profits with other profitable jobs.

Finally, transferring risk is the insurance component of managing risk. When you pay insurance premiums, you are transferring risk to the insurance company. You cannot transfer all of your risk, though, because, generally you, must pay a deductible when there is an insurance claim, which is an act of retaining risk.

Creating a risk management plan should entail a process similar to the following steps:

1. Establish program objectives.
2. Identify all types of risks.
3. Evaluate probability of loss and potential amount of loss for risks.
4. Analyze options for handling each risk and identify one (or more) methodology to do so.
5. Implement the methodology or methodologies.
6. Periodically review the results of the risk management program and make changes when necessary.

When establishing objectives, you should think about the type of loss you are trying to prevent and how you will act in case of a loss. Pre-loss objectives could include bonding requirements, preventing workplace injuries, reducing economic risks and promoting the company's image. Some post-loss objectives could include maintaining income streams, continuing growth, maintaining operations and preserving the company's image.

The most important thing to remember when establishing a risk management program is to set objectives. Sometimes insurance will provide the answer to risk management; but there are many risks not covered by insurance, and there are many ways to handle risks outside of insurance. We would be happy to work with your construction company to achieve its goals, of which risk management should be an integral part. If you would like to discuss this topic, please call one of our construction industry advisors.

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## **Fraud Deterrence**

*by Theresa DelPonte*

During a down economy, fraud becomes a more likely option to some employees to help alleviate their financial woes. This economy downturn is no different from those in the past, and fraud is becoming more rampant among businesses across the nation.

As business advisors, we stress the importance of internal controls to prevent fraud and theft and to ensure the accuracy of accounting data. However, many situations still

exist in which contractors fail to establish adequate control systems to reduce transaction costs for a number of reasons. Some contractors lack information while others lack personnel. Still others put full trust in employees, vendors or others with whom the company interacts. Here are some highlights of sound internal control practices that should exist at most large companies.

- Employees should be made aware of internal controls and instructed never to override the system.
- There should be a chart of accounts so transactions will be recorded both uniformly and accurately.
- There should be a system of subsidiary ledgers that can be reconciled with specific general ledger accounts.



- An internal reporting plan needs to be established so that there is appropriate supervision and authorization at all levels and to provide accountability.
- There needs to be an independent reconciliation of cash, accounts receivable, accounts payable, inventories, etc.
- Written job descriptions should exist for all positions.

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