

Insight

Payroll & Reporting Update

Tips for Preventing Payroll Fraud in Your Business

by Joel Flinchbaugh, CPA - Carlisle

Small businesses, those with fewer than 100 employees, are the most vulnerable to fraud according to the Association of Certified Fraud Examiners (ACFE) in their **2008 Report to the Nation on Occupational Fraud and Abuse**. While fraud can take many forms, embezzlement through a company's payroll system ranks among the most prevalent.

The nature of a small business itself can facilitate fraud. Small businesses typically are run with a family atmosphere where business owners demonstrate a high level of trust of their employees, have fewer or weaker internal controls (cited as #1 factor that allowed fraud to occur) and a lack of segregation of duties. All of these factors create a ripe environment for a dishonest employee to manipulate procedures for personal gain.

Even more discouraging is the fact schemes frequently continue for years before they are detected. The typical payroll fraud had a median duration of 25 months. And we're not talking small amounts, the ACFE report cites the median loss suffered by organizations with fewer than 100 employees was \$200,000.

There are typically three types of payroll fraud:

1. **Use of "ghost" employees** – ghost employees are employees on the payroll who don't actually work for the company. The ghost is frequently a recently departed employee, friend or relative of the fraudster, or sometimes even a completely fictitious person.
2. **Falsifying of hours or salary** – dishonest employees exaggerate the time they work in order to increase their compensation, or look for internal control deficiencies that will permit them to adjust their own salaries. A popular option is to arrive early and clock in, leave the work site for the day and then return later to clock out.

Employees may collude with fellow employees to take turns with this "buddy-punching" scheme. Fraudsters may also work in collaboration with supervisors to approve falsified hours (for a share of the take).

3. **Commission schemes** – salespeople and other commission-based employees may increase their pay by falsely increasing the amount of sales or their commission rate. This can be accomplished through the falsification of sales documents, such as sales orders, purchase orders and invoices.

Seeing Ghosts

The most prevalent form of payroll fraud is the use of ghost employees. Simple measures can prevent or detect many of these schemes.

- Ensure payroll preparation, disbursement and distribution functions are segregated.
- Look for paychecks without deductions for taxes – completely fictitious employees usually won't have any.
- Examine returned/cleared payroll checks that have dual endorsements. Two signatures could signal the forgery of a departed employee's endorsement.

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INSIGHT HAS GONE GREEN!

In an effort to be earth-friendly we are now exclusively providing the Insight newsletter on-line.

In addition to saving a few trees, the on-line format will allow you to refer to Insight at your convenience by simply visiting our website www.sek.com.



Smith Elliott Kearns & Company, LLC
Certified Public Accountants & Consultants

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E-Verify, Employers and Federal Contractors

by Peter McDonald - Hagerstown

E-Verify is an electronic, web-based system that allows employers to verify the employment eligibility of newly hired employees. It is the most complete system available for determining employment eligibility and validity of Social Security numbers. Enrollment in the program is free.

E-Verify is a partnership between the Department of Homeland Security (DHS) and the Social Security Administration (SSA) and is administered by U.S. Citizenship and Immigration Services.

The purpose of E-Verify is to reduce unauthorized employment and minimize verification-related discrimination. The program works by allowing employers to compare

employee information taken from the Form I-9 against records in the SSA's and DHS' databases. Results are available within seconds.



Commencing September 8, 2009, federal contractors and subcontractors were

required to start using the E-Verify system. This new requirement implements Executive Order 12989 which reinforces the policy that the federal government does business with companies that have a legal workforce. Federal contractors will be required to agree to use the system via language inserted into their federal contracts.

As of September 8, 2009, all federal contracts awarded will include a clause requiring subcontracts over \$3,000 for services or construction to also use the E-Verify system. Contracts exempt from this rule include those that are for less than \$100,000 and those that are for commercially available off-the-shelf items. Federal contractors will be required to enroll in E-Verify within 30 days of the contract award date. They will need to begin using the system to verify all of their new hires and current employees working directly on federal contracts are authorized to legally work in the United States.

For more information about the E-Verify system, visit the United States Citizenship and Immigration Services website at www.uscis.gov and click on the E-Verify Home Page link.

To enroll in the program, visit <http://e-verify.uscis.gov/enroll>.

As always, you can contact any of our offices and someone will be glad to answer questions you might have regarding E-Verify.

The Basics of "Use Tax"

by Lisa Ankastrand, CPA - Carlisle

What is use tax?

Use Tax is really just another name for sales tax. There are two typical ways that you could be subject to use tax. The first is by purchasing a taxable item where the supplier does not collect sales tax from you. The other scenario where use tax is typically incurred is when an exemption (resale, manufacturing, etc.) is claimed when purchasing an item and that item ends up being used for a taxable purpose.

Some of the more common examples of transactions subject to use tax include: purchases made over the Internet, through toll-free numbers, from mail order catalogs, out-of-state transactions and items bought for resale and then ultimately consumed in the business.

How does a business report use tax?

If you are registered to collect and report sales tax, the sales tax return contains a line to report taxable purchases. If you are not registered, you can usually file a Use Tax Return directly to the Department of Revenue for your state.

What if use tax is not paid?

States can identify those who owe use tax by various methods. These include routine audits, self-assessment programs, complaints, investigations and by obtaining lists of out-of-state purchases through the cooperation of vendors and other states.

When an assessment is issued for a use tax liability, both penalty and interest charges will be imposed. If you have any questions whether you may be responsible for use tax, please call our office.

Attention Philadelphia Shoppers!



On October 8, 2009, the sales tax rate in Philadelphia increased from 7% to 8%.

The temporary sales tax hike was a key component of the Philadelphia fiscal-relief bill signed into law by Governor Rendell. It is expected to generate an additional \$10 million a month for Philadelphia until the tax is rolled back to 7% in 2014.

The new rate is lower than those of most other big U.S. cities, but two percentage points higher than the rate levied in the Pennsylvania suburbs.

Keys to Avoiding Unnecessary Unemployment Costs

by Sarah Foster, PHR - Human Resources

With the downturn in the economy and the national unemployment rate hovering around 10%, many states are being forced to increase employer unemployment contribution rates in order to keep state unemployment funds solvent.

The state of West Virginia increased their wage base from \$8,000 to \$12,000 in 2009, while the state of Maryland will be increasing employer rates by as much as 250% for 2010.

Other states are likely to follow suit in the near future. These changes can place an additional financial burden on your company when you are already feeling the pinch from the depressed economy. What you may not realize is how much control you and your company have over unemployment compensation costs.

In order to realize the potential cost savings, you should first understand how unemployment compensation programs are funded. Your company is assessed an unemployment contribution rate based on the amount of unemployment compensation paid to former employees. Most states compare the amount of claims filed by former employees of your company over the most recent three years with the total amount of payroll expense incurred by your company for the same time period. The percentage of total claims to total payroll incurred is used to determine your company's unemployment rate. Your company is generally assigned a lower contribution rate when former employees make fewer claims against your unemployment account.

The first key in controlling or preventing unnecessary unemployment compensation costs is to take the time to hire the best qualified applicants. This begins with an in-depth interview that assesses not only an applicant's skills, but also behaviors. By asking behavior-based, open-ended questions, you will be able to assess the applicant's work ethic, work group preferences, triggers for stress and how the applicant copes with stress, communication and analytical skills. In addition to the interview, you should take the time to verify an applicant's background, check references, and consider how the applicant will fit with your current work environment.

Studies have shown when employees are well suited for a job and are treated fairly, they are more likely to stay with a company. You can control or prevent unnecessary unemployment compensation costs by taking the time to hire the right applicant for each open position and cultivating an environment of retention. Since your unemployment contribution rate is based on the number of unemployment claims filed and paid, your bottom line can be positively or nega-

tively affected by former employees' claims and payments for unemployment compensation benefits.

The second key in controlling or preventing unnecessary unemployment compensation costs is to use the necessary resources to offer each new employee a thorough orientation and training period. Unemployment claims may hinge on your ability to prove that an employee was properly oriented and trained. Without orientation and training, employees may feel they are not valued or respected, possibly resulting in higher turnover and increasing the amount of unemployment claims paid.

Offering an orientation program and training period shows you value each new employee and demonstrates your willingness to provide the necessary time and tools needed to ensure a successful relationship. Starting out on the right foot and continuing to offer on-the-job training and opportunities to further employees' knowledge and skills are characteristics of a proactive employer.

The third key in controlling or preventing unnecessary unemployment compensation costs is to document, document, document. Supervisors should document each employee's achievements and areas for improvement not only in annual performance evaluations, but throughout the employment year.

One important reminder – do not play favorites! Failure to coach or discipline one of your employees for a policy violation may seriously undermine all your policies and procedures. In order for a state unemployment agency to assess your policies and procedures as fair and applied to all employees equally, it is the employer's responsibility to provide evidence that they are consistently enforced.

One way to ensure you are applying policies and procedures consistently is to adopt a progressive discipline plan. Disciplinary action may call for any or all of four steps – verbal warning, written warning, suspension with or without pay, or termination of employment – depending on the severity of the problem and the number of occurrences.

If you are scheduled to attend an unemployment hearing, you will need to provide first-hand testimony and written records or documents that support your testimony. Documenting all achievements and misconducts in a timely manner will enable you to present the necessary evidence indicating all your policies and procedures are enforced fairly and equally. Following these best practices offer you the best opportunity to minimize the charges to your unemployment account and as a result, could reduce future increases in your unemployment costs.



Employee Awards & Gifts - Taxable or Non-Taxable?

by Deb Meckley - Hanover

Rewarding employees with a special award or gift is a common way to recognize a staff member who has done an excellent job, has served your company for many years or just as a way to say thank you around the holidays. Unfortunately, there may be tax consequences associated with such recognition.

Are employee awards and gifts taxable?

In short, it depends. All cash or cash equivalent awards and gifts are taxable but there are some exceptions for non cash awards and gifts.

LENGTH OF SERVICE OR SAFETY ACHIEVEMENT AWARDS

Employers are not required to include the value of awards for length of service or safety awards in the employees' taxable wages if the value is deductible as an employer business expense. For the employer to be able to deduct the award it depends on whether the award meets several general and specific requirements and whether it is granted under a qualified or nonqualified plan.

General requirements

The award must be tangible personal property which does not include cash or cash equivalents, stocks, bonds, vacations, meals, lodging or tickets to theater or sporting events. The award must also be presented in a "meaningful presentation". The presentation need not be elaborate but simply recognition of the employees' achievement at a gathering of other employees. The award must not be "disguised compensation" which might be an award that is given at the time of a salary review or by an award that cost the employer much less than fair market value.

Specific length of service award requirements

To qualify as a deductible achievement award, the length of service award must not be presented to an employee with less than 5 years on the job and must not have been given to that employee within the last four years. Retirement awards are length of service awards although they may also be considered de minimus fringe benefits (e.g., a gold watch for 25 years of service)

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Beware of QuickBooks® Software "Sunset Rules"

by Steve Lubart, CPA - Chambersburg

Each year, QuickBooks® introduces the latest version of its accounting software product. Like new vehicles, the latest edition usually hits the shelf in the fall. QuickBooks® 2010 was introduced a few months ago and once again users will have a decision whether or not to upgrade to the latest edition.

Understanding "Sunset Rules"



QuickBooks® will support the latest three versions/years of software. If you are using QuickBooks® 2007 and processing payroll in the software, you will be required to upgrade to the 2010 version by May

31, 2010 to continue to process payroll correctly. In addition to payroll features, QuickBooks® lists the following key features that will no longer be available to users of QuickBooks® 2007 after May 31, 2010:

- Employee Organizer
- Merchant Service
- Billing Solution (formerly QuickBooks® Online Billing)
- QuickBooks® Email
- Bill Pay
- Online Banking
- Credit Card Download
- Technical Support Plans and Services

To Upgrade or Not to Upgrade?

Each year, a common question from clients is whether they should upgrade to the newest version. Our general recommendation is to upgrade your QuickBooks® software, by purchasing the latest version, at least once every three years.

If you plan to upgrade your QuickBooks® software, call us to take advantage of our ProAdvisor™ pricing – which could save you up to \$130 off the suggested retail price.



2010 STANDARD MILEAGE RATES

BEGINNING JANUARY 1, 2010, the standard mileage rate will be 50 cents per mile for business purposes (compared to 55 cents per mile in 2009), 16.5 cents per mile for medical or moving purposes (compared to 24 cents per mile in 2009), and 14 cents per mile for service to a charitable organization (unchanged from 2009).



TAX CALENDAR

By December 31, 2009

- Remind employees to submit a new Form W-4 if they need to change their withholding or will be exempt in 2010

By February 1, 2010

- Furnish copies of Form W-2 to employees and Form 1099 as required to other payees
- File most federal, state, and local payroll tax returns and final payments for 2009

By March 1, 2010

- File Forms 1096 and 1099
- File Form W-2, Copy A, along with Form W-3, to the Social Security Administration
- File Form 8027, Tip Income & Allocated Tips

By March 31, 2010 (Electronic Filing)

- File Forms 1096, 1099, W-2, W-3, and 8027

Tips for Creating a Budget

by Steve Lubart, CPA - Chambersburg

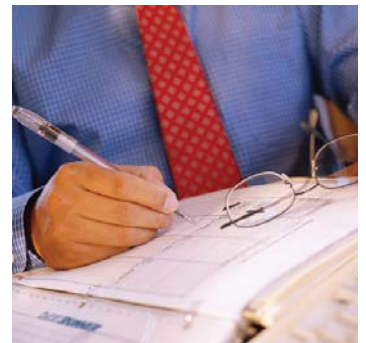
A budget is the most fundamental and most effective financial management tool available to your business. Whether you are earning thousands of dollars a year or hundreds of thousands of dollars a year, budgeting should be a priority and part of your overall business financial management plan. In its simplest form, budgeting is about planning, which is crucial to producing desired results for your business.

BUDGETING TIPS:

Realistically project income and expenses.

Fixed monthly costs can be entered in the first month and copied across the entire twelve months.

Expenses can also be compiled from a list of scheduled expenses (such as utilities, rent, etc.) or from reviewing the expenses of the prior year. Payroll and payroll expenses can be updated by determining if there will be any raises or staffing changes as well as new payroll tax rates.



Income is often the most difficult to budget. Income should be based on historical data, expected contracts, customers and the goods and services you expect to sell to these customers.

Use budgeting features of a bookkeeping software.

Most accounting software programs offer an option to create a budget from the previous year's actual data, which will automatically enter the monthly totals from last year for each account in the current year's budget. Then you can make adjustments where necessary.

Compare actual to budgeted figures monthly.

This creates real value in the management of your business. Again, most accounting programs can produce preformatted reports that calculate variances between actual and budgeted amounts. These reports are the key to determining if your company is on track. Review these reports monthly and update your budget and financial plan where necessary.

As a business owner, there are many demands on your time. Managing the financial aspect of your business is certainly one of them, and we believe a critical one to the ultimate success of your business. We would be glad to help you set up procedures to develop and monitor your business's budget.

NEED FORMS?

For access to federal tax forms, instructions, and publications, click on "Information Center" on the left side menu from our home page.

www.SEK.com

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Employee Awards & Gifts - Taxable or Non-Taxable?

Specific safety award requirements

Safety award will not qualify as deductible employer expenses if the employer has presented them to 10% of its eligible employees during the taxable year or if they are presented to managers, administrators, professional employees or clerical employees.

Qualified plan awards

Achievement awards that meet the general requirements are awarded under a qualified plan if the employer has a written plan that does not discriminate in favor of highly compensated employees. The average cost of all qualified plan awards presented by the employer during its tax year (except those costing the employer \$50 or less) may not exceed \$400 or none of them will be considered qualified plan awards. The total deduction allowed to the employer for qualified plan awards must not exceed \$1,600 per employee per year.

Nonqualified plan awards

The employer is limited to a total deduction of \$400 per employee per year for awards that are not granted under a qualified plan but that meet the general and specific requirements for deductibility.

If the award exceeds the limit on the employer's deductibility, the amount that must be included in the employee's income is the greater of 1) the difference between the employer's cost and the deduction limitation and 2) the difference between the award's fair market value and the deduction limitation. If the award is given before the required number of years of service, the entire amount is taxable and included in income.

EMPLOYEE GIFTS

For many business', giving holiday gifts to employees is a tradition. While some employers prefer to give tangible gifts such as turkeys, hams, movie tickets or other items, some like to give cash or gift cards.

Nominal gifts such as the turkeys, hams and movie tickets are generally considered non-taxable de minimus fringes. The IRS defines a de minimus fringe as "any property or service the value of which is so small as to make accounting for it unreasonable or administratively impracticable after taking into account the frequency with which similar fringes are provided by the employer to the employer's employees." This means their value is so small and they can be an expense for the business but not included as part of the employee wages that are subject to employment taxes.

Gifts of cash, gift cards or travelers checks of any amount or value are considered taxable to employees



and must be included in the employee's taxable wages and reported on their W-2. These items are cash

equivalents and are considered by the IRS to be additional wages. If a gift card is purchased for an employee and it is only redeemable for a particular item such as a turkey, this gift card value would be taxable because it is considered a cash equivalent, even though the turkey would be considered a de minimus fringe.

As you can see, the rules for the taxability of employee awards and gifts are complicated. As always, If you have any questions, regarding your specific circumstances, please give us a call.

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Tips for Preventing Payroll Fraud in Your Business

- Use direct deposit – although not foolproof, it will cut down on the opportunity for forgery of paper checks. Further customize the system to reject duplicate bank accounts.
- Check payroll reports for duplicate entries – names, addresses, SS#, bank account numbers
- Occasionally hand-deliver paychecks to employees and require identification for those you don't know.
- Require payroll employees to take an annual vacation, and remember to check for inactive employees – the fraudster may change ghost employees to inactive during their vacation to avoid detection.

Falsifying of hours or salary can be remedied by requiring supervisors to stand by the time-clock at the beginning and end of a shift, or incorporate a fingerprint scanner into the company's time clock to avoid "buddy-punching". Commission schemes can be alleviated by implementing proper internal controls and segregation of bookkeeping duties.

Finally, ALWAYS have an owner review payroll records multiple times a year to ensure employees are known and wages paid to date appear appropriate. A few minutes of review could save thousands of dollars in pain.

If you do not have enough staff or they are not adequately trained in payroll procedures, you may want to consider outsourcing the payroll function. SEK&Co offers customized payroll services and can serve an important role in managing your risk against payroll fraud.