Every two years, the Association of Certified Fraud Examiners (ACFE) publishes a study detailing the costs, schemes, perpetrators, and victims of occupational fraud. The 2014 edition of the Report to the Nations on Occupational Fraud and Abuse was recently released. It covers nearly 1,500 cases of white collar crime, occurring in more than 100 countries. Approximately 650 of these cases involved U.S. organizations.

Could your business or organization be the next victim of this global epidemic?

**How Much Does Fraud Cost Annually?**

Consistent with previous studies, the 2014 report estimates that the typical organization loses 5 percent of its revenues each year to fraud. Based on the latest Commerce Department estimate of 2013 U.S. gross domestic product ($16.8 trillion), domestic organizations lost about $840 billion to fraud last year.

However, the ACFE study exposes only the tip of the iceberg. Many frauds go undetected or unmeasured. Plus some losses are indirect, including lost productivity, reputational damage, and the related future loss of business. Fraud investigations can also be costly, so some organizations opt to cut their losses by simply terminating -- but not prosecuting -- white collar criminals.

In other words, the true losses from asset misappropriation, corruption, and financial statement fraud are probably much higher than the study suggests. Many of these losses are never fully recovered.

**Proactive Firms Fight Fraud Head-On**

The threat of being caught is a powerful deterrent of fraudulent behavior. But some detection methods are more effective than others. The following proactive detection methods revealed frauds with the shortest durations and lowest losses:

- Surveillance/monitoring;
- Account reconciliation;
- IT controls;
- Internal audit; and
- Management review.

Conversely, detection-by-chance -- for example, through a confession or notification by police -- tends to reveal longer, more costly fraud schemes. The 2014 Report to the Nations concludes:

“Having adequate controls that seek out fraud, rather than relying on external or passive detection methods, can dramatically reduce the cost and duration of such schemes.”

Strong internal control systems may require significant time and money to implement, but they can be resources well spent if fraud occurs at your organization.

A formal code of conduct is an example of a simple, but effective, internal control
mechanism that any organization can implement to fight fraud. Although the vast majority of employees will never commit fraud, those who are tempted can be put off by a code of conduct that clearly outlines a zero-tolerance policy on unethical behaviors. It should contain clear illustrations and information about behavior that would violate the code, as well as instructions on how to confidentially report suspicious behavior that could be fraud.

Surprisingly, the ACFE study reports that background checks are not a particularly effective method of detecting fraud. That’s because most frauds are committed by individuals without a criminal record who have worked for their organizations for many years.

However, this finding doesn’t necessarily mean that the company was the fraudster’s first victim. It’s possible that his or her attempts to steal from former employers went undetected. Or maybe the individual wasn’t prosecuted by a former employer to preserve the organization’s resources and reputation.

Prosecuting white collar criminals is important for several reasons. It helps recoup fraud losses, sets an example for other would-be fraudsters in your organization, and protects future employers from becoming the next fraud victim.

**Ask for Help**

Honest employees are an organization’s first line of defense against white collar crime. Tips are the most common method of detecting fraud. Employees were the source of nearly half of those tips, according to the ACFE study.

Here are some ways you can encourage employees to join in the fight against fraud:

- **Invest in training.** Educate staff on the red flags associated with fraud from within and outside the company. This helps detect and prevent fraud. It also sends a powerful message about your company’s intention to fight fraud no matter where it originates. Employees must perceive a high probability that fraudulent activity will be detected. The perception of detection is often sufficient enough to dissuade them.

- **Engage management in the fight.** Managers must be seen and heard reviewing controls and urgently correcting weaknesses that might be detected. If your organization’s managers are perceived to be unwilling or unable to take the time to review the controls, they may inadvertently be sending a message that it is safe to commit fraud.

- **Set up a hotline.** Fraud reporting hotlines can be an effective method of obtaining tips about unethical behaviors. Unfortunately, many small businesses shy away from hotlines, because they think hotlines are too expensive and difficult to administer. A number of providers offer hotlines designed explicitly with small businesses in mind. The cost per employee is minimal in relation to the fraud it can help to uncover and the losses avoided.

The 2014 *Report to the Nations* revealed that tips are the most common detection method for organizations with and without hotlines, and employers are much more likely to be tipped off if they offer reporting hotlines. ACFE reports that tips led to the detection of fraud in 51 percent of the cases involving organizations with reporting hotlines, but only 33 percent in organizations without hotlines.

The fact that more than half of all tips involved parties other than confirmed employees emphasizes the importance of cultivating tips from various sources. So it’s also advantageous to educate vendors, customers, and owners on how to report suspicions of fraud.

A proactive approach to protecting your organization is always the most cost effective solution. Call Anthony Schuster, CPA, CFE at 330-453-7633 or email him at anthony@hallkistler.com. He can help your business design or reinforce its internal controls and investigate if you suspect fraud. Doing so can potentially save your company a bundle in losses and put everyone on alert that fraud will not be tolerated, and the consequences will be severe.
The issue of whether workers should be classified as employees or independent contractors for federal employment tax purposes has been a source of controversy for decades. The saga continues. This article summarizes a recent U.S. Tax Court decision on the classification of a manager in the home care industry.

**Note:** To make things more understandable in this article, we will call businesses that hire workers "employers" (whether the workers are employees or independent contractors), and we will call the individuals who get the job done "workers" (whether they are employees or independent contractors).

### Why Worker Classification Matters

When a worker is properly classified as a common-law employee, the employer generally must withhold from the worker's wages:

- Federal income tax (FIT); and
- The employee's portion of the Social Security and Medicare taxes (FICA tax).

The employer must also pay the employer's portion of the Social Security and Medicare taxes, pay federal unemployment tax (FUTA), file federal payroll tax returns, and comply with various IRS and Department of Labor (DOL) rules and regulations.

In addition, the employer may have to deal with state and local income tax withholding, pay state unemployment and Workers' Compensation taxes, and comply with even more local rules and regulations. Handling all of this red tape can cost a bundle every year for each employee. If employee benefits -- such as health insurance, paid vacations, and sick leave -- are also provided, the cost of keeping a common-law employee on the payroll can become prohibitive.

In contrast, when a worker is properly classified as an independent contractor, the employer must simply provide the worker and the IRS with a Form 1099-MISC each year to report how much the worker was paid. That's why many businesses prefer to treat as many workers as possible as independent contractors instead of employees.

### Common-Law Employee vs. Independent Contractor

Common-law employees are workers considered to be employees (as opposed to independent contractors) based on various statutes, regulations, and court decisions. IRS and DOL rules can differ from state and local rules. That said, if an employer is allowed to treat a worker as an independent contractor under IRS rules, it will generally be the same across the board. Therefore, this article only discusses the IRS rules.

Properly classifying a worker as an independent contractor is beneficial because the employer doesn't have to worry about employment tax issues or provide expensive fringe benefits.

However, when an employer mistakenly treats an employee as an independent contractor, the employer could owe unpaid employment taxes, as well as interest and penalties. The employer also may be liable for employee benefits that should have been provided but were not. So, it's important to get worker classification questions right.

### Facts of the Tax Court Case

In its recent decision, the Tax Court used the seven factors above to evaluate whether a worker who provided home care services to disabled clients was an employee. The taxpayer in this case, Atig Rahman, was hired by Ever Care Adult Care Services, which provides home and other care services to disabled adults. The taxpayer was quickly promoted to manager of a group home, where he worked about 40 hours per week and was paid at an hourly rate every two weeks.

Ever Care dictated the taxpayer's duties and responsibilities, which included preparing a monthly financial forecast, hiring and firing staff, scheduling staff hours, meeting with officials from the Florida state licensing agency, maintaining and repairing the facilities, buying groceries for the home, assisting residents with personal grooming, and arranging transportation for residents. The taxpayer also met weekly with the owner regarding grocery purchases and gave the owner daily status reports.
Although Ever Care treated the taxpayer as a self-employed independent contractor and issued him a Form 1099-MISC, he did not pay any self-employment (SE) tax for the year in question. After an audit, the IRS claimed he was an independent contractor and issued an assessment for unpaid SE tax.

The Court's Decision

The Tax Court analyzed these seven factors and found that none of them supported the self-employed independent contractor status:

**The degree of control.** The Tax Court found that Ever Care had the right to control the taxpayer's work and did in fact exercise a high degree of control by:

1. Specifically enumerating his duties and responsibilities;
2. Specifying when and where his duties were to be performed; and
3. Requiring frequent reports to the owner.

**Investment in equipment and facilities.** The taxpayer did not provide his own equipment or facilities.

**Opportunity for profit or loss.** Ever Care paid the taxpayer at an hourly rate, so he had no open-ended opportunity for profit or loss.

**The right to discharge.** Ever Care retained the right to discharge the taxpayer and did, in fact, discharge him the following year.

**Work related to the core business.** The work performed by the taxpayer was an integral part of Ever Care's core business of providing home care and other services to adults with disabilities.

**Permanency of relationship.** The taxpayer worked full-time for Ever Care for approximately nine months, at which point he was discharged. While it lasted, the relationship between Ever Care and the taxpayer was not thought to be temporary or short-term by either party.

**The relationship between the parties.** Ever Care treated the taxpayer as a self-employed independent contractor by issuing him a Form 1099-MISC and not withholding taxes from his pay. While this indicated that Ever Care intended for the taxpayer to be an independent contractor, this intention was self-serving because it allowed Ever Care to avoid paying employment taxes on his compensation and benefits.

Because all but the last factor weighed in favor of the taxpayer being a common-law employee, the Tax Court ruled that he did not owe self-employment tax because he was not a self-employed, independent contractor (Atig Rahman, T.C. Summary Opinion 2014-35).

**Bottom Line**

While the Rahman decision was in favor of the taxpayer-worker, it opened the door for the IRS to go after the employer for unpaid federal employment taxes, interest, and penalties. Therefore, the decision is yet another cautionary tale that failure to properly classify workers can be an expensive mistake for employers. In many cases, proactive planning can lock in tax-saving independent contractor status for workers. But, if nothing is done before an IRS audit takes place, it may be too late to achieve the desired tax-saving results. Consult your tax adviser if you have questions about worker classification.

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**Seven Factors to Decide Worker Classification**

The Tax Court considers these factors when deciding whether workers should be classified as independent contractors or employees for federal employment tax purposes:

1) **Degree of control.**
   
   When an employer exercises significant control over how a worker performs duties or has the right to do so, this factor indicates employee status. When there's little or no control or right to exercise it, this factor indicates independent contractor status.

   Based on longstanding tradition, this factor is considered the most important. So, it's often used as the tie-breaker in situations where there are an equal number of factors on both sides.
2) Investment in equipment and facilities.
When the worker covers most or all of the cost of equipment and facilities used for the job, this factor indicates independent contractor status. For example, say the worker performs his duties out of an office in his home using equipment (computer, printer, and phone) that he pays for himself. In such a case, this factor would clearly indicate independent contractor status. On the other hand, if the employer provides most or all of the equipment and facilities, this factor would indicate employee status.

3) Whether the worker has an opportunity for open-ended profit or outright loss.
A worker, who can make an open-ended profit through the strength of his or her own efforts, or alternatively, suffer an outright loss on the job, is likely to be an independent contractor rather than an employee. For example, this would be the case when an outside sales person is paid by commission only.

On the other hand, when the compensation arrangement dictates that the worker can only make a fixed profit and not suffer a loss, it indicates employee status. For example, this would be the case when the worker is paid a fixed amount for each day of work and the only significant job-related expense is the cost of commuting to and from the work site.

4) Whether the worker can be discharged.
A worker who can be discharged is more likely to be an employee than an independent contractor.

5) Whether the work is related to the employer's core business.
When the worker's duties relate to the employer's core business it indicates employee status, while work related to a tangential enterprise indicates independent contractor status.

6) The permanency of the relationship between the employer and worker.
Lack of permanency indicates independent contractor status, while permanency indicates employee status.

7) The relationship the employer and worker believed they created.
If the employer and the worker believed the same thing at the time they entered into their arrangement, courts rule this factor can indicate either employee or independent contractor status, depending on the facts. If the parties believed two different things, this factor may be thrown out.

Hallkistlerblog.com: Determining Business Valuations

By Seth Turner, CVA, Supervisor
At Hall Kistler & Company, we understand that valuing a business is part art and part science. Creativity, knowledge and experience are combined to derive business valuations. A lot of information is available, but how does it apply to your business? What trends is your business adhering to or avoiding? Changes in the economy, software, internet information, tax law and reporting standards means it is now more important than ever to engage a business valuation professional to address the question “How much is my business worth?”

With approximately 10,000 baby boomers reaching retirement age per day, questions about business valuations are getting asked more frequently. If you have not considered these questions, now is the time to do so. A business valuation can prepare your business for sale, gifting and other retirement planning. If owner expectations do not meet value, steps can be taken now to best prepare your business for its future.

As Valuation theory and practice continues to evolve, so too does Hall, Kistler. We have access to the latest valuation, industry and economic data. Hall, Kistler retains three Certified Valuation Analysts (CVA) who have over 40 years of experience and are trained in new techniques in the art and science of business valuations.

To learn more about business valuations contact Seth Turner, CVA at 330-453-7633 or seth@hallkistler.com and visit us online at: http://www.hallkistler.com/business-valuations
IRS Clarifies Its Position on Contributing to Employee Health Coverage

Last year, the IRS spelled out how it would treat employer contributions to employees to help them buy coverage on their own. More recently, it reiterated its position in Q&A format. The question the IRS posed to itself:

What are the consequences to the employer if the employer does not establish a health insurance plan for its own employees, but reimburses those employees for premiums they pay for health insurance (either through a qualified health plan in the marketplace or outside the marketplace)?

Employer Payment Plans

In answering its own question, the IRS characterized such arrangements as "employer payment plans." These are different from health reimbursement accounts (HRAs) and healthcare flexible spending accounts (FSAs).

The IRS considers employer payment plans as group health plans, subject to the provisions of the Affordable Care Act (ACA), including the ban on annual limits for essential health benefits and the requirement for full coverage of preventive health services. But, even if employees bought coverage that featured those benefits, employer payment plans "cannot be integrated with individual policies to satisfy the market reforms," according to the IRS.

The penalty for having an employer payment plan would make it prohibitively expensive. Specifically, employers could be subject to an excise tax as high as $100 per day per employee (that is, $36,500 per year per employee).

The IRS and the U.S. Department of Labor also take the position that an HRA cannot be integrated with "individual market coverage or with an employer plan, which provides coverage through individual policies" without violating the ACA. However, HRAs and healthcare FSAs can still be used to help employees pay for "excepted" benefits, including vision, dental, accident, long-term care, and automobile medical payment coverage.

Wraparound Coverage

Another form of health coverage, not subject to ACA requirements, which employers can help employees buy beginning in 2015 without being penalized, is "wraparound coverage." That's basic health insurance to supplement a standard health plan, which meets ACA requirements. However, this coverage cannot cost more than 15 percent of the cost of the basic health plan offered to your employees.

If you are still determined to get out from between your employees and their health plan coverage, you could avoid the "employer payment plan" penalties by simply giving employees a pay raise sufficient to subsidize their health benefits to the degree you want and can afford.

Keep in mind, however, you will be subject to higher payroll taxes, and since this income is taxable to employees, the amount of the raise they'll have available to buy health coverage will be reduced by their added tax liability. Also, workers may eventually forget why they got the raise, and consider themselves employees of a company that doesn't value its workers enough to offer health benefits.

Finally, if you are large enough to be subject to the ACA’s employer mandate, the salary increase tactic won't allow you to avoid the penalty for not providing health coverage.

Hall, Kistler & Company Launches New Blog and Facebook Page

Hall, Kistler & Company has broadened the scope of its communications with the addition of a company blog and an official Facebook page. Both of these new online channels are intended to deliver the latest industry regulations, news and insights, along with analysis from Hall, Kistler's team of consultants and certified public accountants.

“We hope to foster discussion and encourage a flow of ideas where individuals and organizations may learn from each other as well as from our posts,” said Hall, Kistler & Company, Managing Partner Karen M. Brenneman, CPA, MT.

Topics the blog and Facebook page will address include regulations and updates relevant to the oil and gas, manufacturing, non-profit and healthcare industries.

To read the blog, visit: http://www.hallkistlerblog.com
To "like" Hall, Kistler & Company on Facebook, visit: https://www.facebook.com/pages/Hall-Kistler-Company-LLP/170517536298623
Recently Mike Eberhart and I were asked to present a webinar entitled “Overview of Oil and Gas Accounting.” The webinar was part of a series of oil and gas webinars sponsored by Bisk CPEasy, now part of Thomson Reuters, a national continuing professional education provider.

As we discussed during the webinar, the two methods used in oil and gas accounting are (1) successful efforts and (2) full cost.

Accounting in the oil and gas industry requires an analysis of the various costs incurred by oil and gas companies in the process of acquiring and leasing properties and also the drilling of the oil and gas property and producing oil and gas from that property. The calculation of depletion and amortization also must be performed, as well as the calculation of potential impairment of oil and gas properties. It is also necessary to calculate asset retirement obligation liabilities.

These are all topics Mike and I spoke about at length during the webinar. If you have any questions about these issues (or any oil and gas related topic), our oil and gas team would love to meet with you and help work through them. Please give us a call at 330-453-7633 or send me an email at andy@hallkistler.com.

To learn more about the work Hall Kistler & Company does in the oil and gas industry, visit http://www.hallkistler.com/oil-and-gas