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NEWSLETTER

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Trends in Business Fraud

As business advisors we are eager to help protect clients from financial harm. Our fraud and forensic accounting group knows about a variety of ways in which people steal. It may be helpful for you to know what we are seeing in professional literature and in our practice.

Wire Transfer Fraud

One of the more recent developments in the fraud area relates to wire transfers. It occurs when the fraudster gains access to a computer that has access to online banking. The perpetrator accomplishes this by sending a phishing email that directs the user to a website that resembles a bank. When the user tries to enter the log-in information, the perpetrator steals this information and then uses it to transfer funds to his or her account. Losses from this type of fraud are limited to the amount of funds in the targeted bank accounts. Small and medium size organizations are most often affected, as they tend to have less sophisticated controls. The FBI has issued an alert related to this type of fraud. A good control to prevent this type of fraud is to isolate the number of computers that have the ability to transfer funds. The computers should be isolated from email servers and other servers that may enable more unauthorized access. Note, in relation to this type of fraud, that legitimate banks do not send emails asking for confidential information.

Bidding/Contract Fraud

The recent recession has significantly impacted the construction industry, creating an environment that can lead to procurement fraud, bid-rigging, and bribery. Private and governmental entities should ensure they have proper controls over procurement practices and contracts.

Procurement Card/Expense Report Fraud

This type of fraud has been around for a long time, but with the recent economic downturn we fear it has become more prevalent. Employees make personal purchases using purchasing cards or through the expense reporting process and try to pass them off to the company as business expenses. Businesses need to take a hard look at their controls over purchasing cards and expense reports to ensure that only properly documented, approved business expenses are reimbursed.

Changes in the ways credit card returns are made have created another opportunity for fraudsters. In the past, a credit would only be given on the account on which the related charge was made. Now, many credit card providers allow credits to be processed to an account other than the originating account. Here is an example of how this situation can be misused: An employee makes a business purchase using a company credit card, which the company then pays, but when the employee returns the merchandise, the refund is applied to his or her personal credit card.

Fictitious Vendors

Fictitious vendor fraud occurs when an employee creates a vendor in the accounting system and then submits an invoice. The invoice looks reputable and appears to be a common business expense. However, the payment will go to the fake company, and the employee will receive the funds. Companies need to ensure that they have proper controls over the approval and set-up of new vendors to mitigate this fraud. This type of fraud can relate to payroll as well – by setting up non-existent ("ghost") employees.

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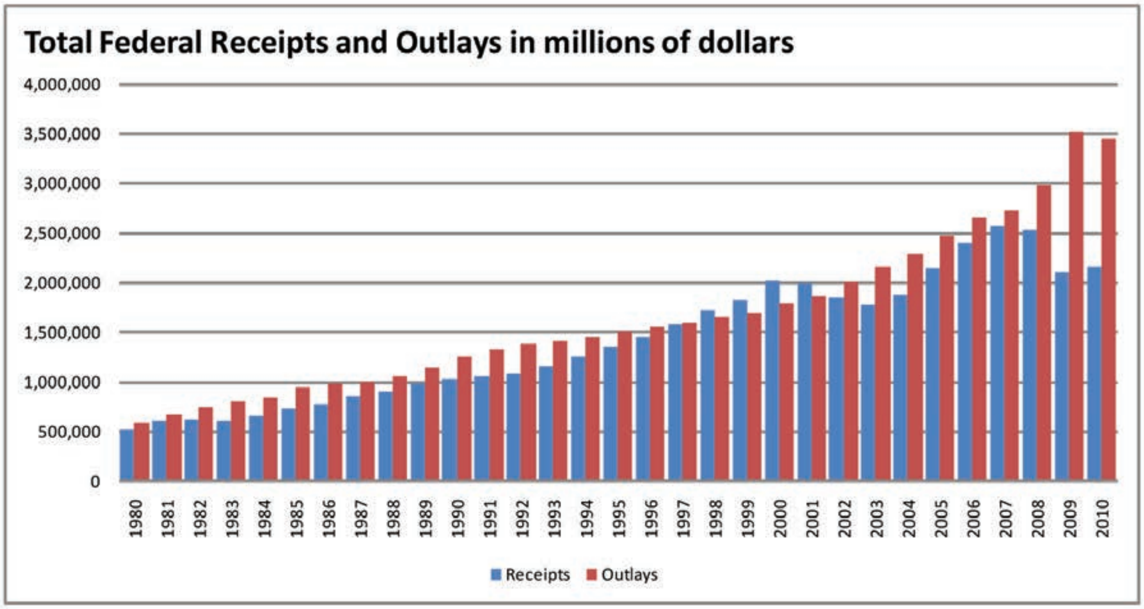
U.S. Government Deficits and Debt

U.S. media and politicians these days are focused to an extraordinary degree on our current and prospective domestic budget and debt level challenges. To help us gain some perspective on these issues, we compiled and graphed some basic U.S. economic data, which we share below.

Graph I



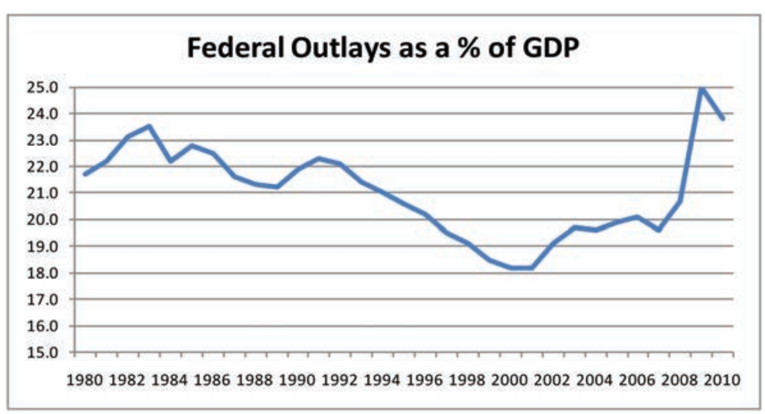
Graph I shows federal budget receipts and outlays for each fiscal year, 1980 through 2010. A few observations:

- Note that Social Security and Medicare are financed "off-budget" and are excluded from this data.
- Outlays exceeded receipts in every year, except 1998-2001, or in 27 of the 31 years shown.
- The enormous deficits in the last two years result from large declines in receipts and large increases in outlays.
- Although we incurred substantial deficits in many years, the 2009 and 2010 deficits dwarf those of any other years shown.
- Searching for any good news, we note that last year's deficit was somewhat less than 2009's, due to a slight increase in receipts and a slight decrease in outlays.
- The level of receipts in 2009 and 2010 approximates the level of receipts in 2000 and 2001 and the level of spending in 2003.

Graph II shows the level of annual budget outlays as a percentage of gross domestic product over the same 1980-2010 period. This statistic measures the portion of our total economy the federal government represents. We make these observations:

- The percentage has ranged from about 18% (in 2000-2001) to 25% (in 2009).
- The percentage declined steadily during the decade of the 1990s, but has generally increased since then.

Graph II



U.S. Government Deficits and Debt
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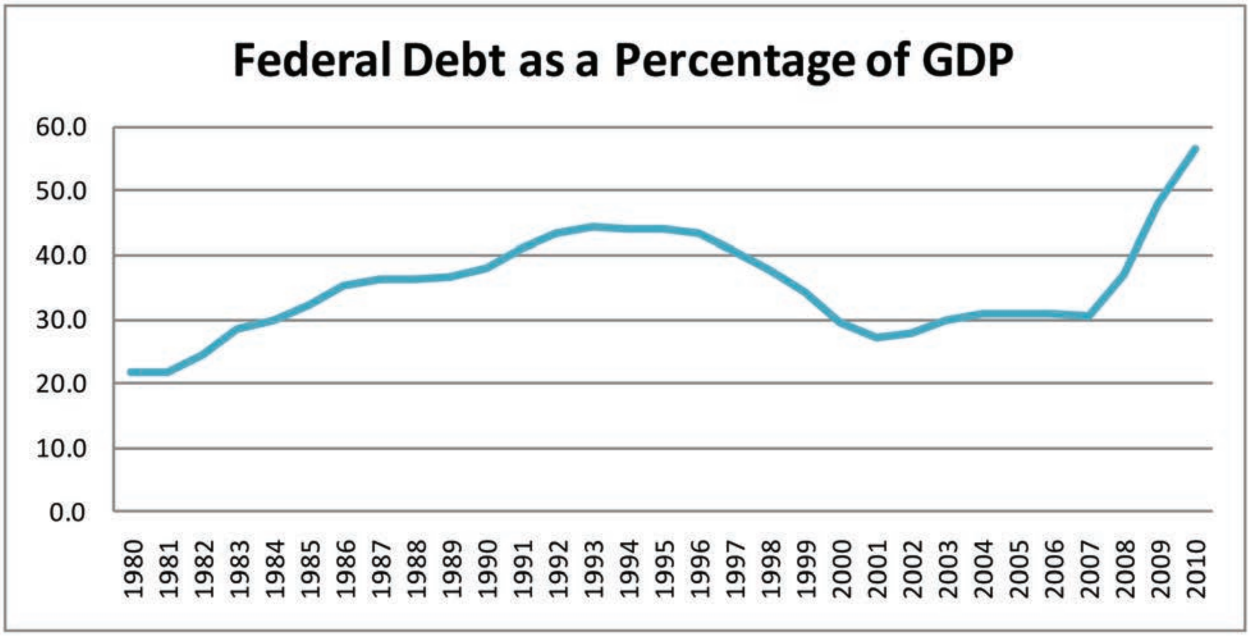
Graph III



Graph III shows federal debt, which we generally can think of as our net cumulative deficit, as a percentage of gross domestic product, over 1980-2010. This statistic measures our debt against our annual economic activity. Our observations:

- In 1980, our debt had accumulated to just over 20% of that year's GDP.
- By 2010, our debt approached 60% of GDP.
- The size of our recent deficits has pushed our debt from about 30% of 2007's GDP to the almost 60% of 2010's GDP.
- Stating the obvious, consider how high this statistic will grow if we fail to make substantial progress in reducing our annual budget deficits.

Recognizing their significances to the overall federal financial outlook, we plan to include some basic data about Social Security and Medicare in a future DDAF Newsletter.

Trends in Business Fraud
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Where opportunity and incentive are present, an environment exists for someone to steal. The incentive to steal usually comes from issues in the thief's life, such as financial distress, drug addiction, or a gambling problem. Businesses must focus on reducing the opportunity to steal and on improving the likelihood of early detection should theft occur.

Elizabeth Z. Woodward & Lance R. Mann
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Kentucky Tax Credit for Certain Gifts to Community Foundations

The **Endow Kentucky Tax Credit** was established in an effort to increase philanthropic activity in Kentucky. This program allows Kentucky taxpayers (business or individual) to receive a Kentucky income tax credit for 20% of gifts to **permanent endowment funds** at qualified community foundations. The credit, which is limited to $10,000 per donor, is nonrefundable, but may be carried over for five years.

Gifts can be of cash or securities. The contribution may be made to an existing or new endowment fund as long as the endowment benefits Kentucky nonprofit organizations. You can find a list of qualifying community foundations at http://revenue.ky.gov/endowedkytaxcredit.htm.

Before making the gift, the donor must file an application with the Kentucky Department of Revenue for preliminary approval of the credit. If approved, the Department will issue a preliminary approval letter. Within 30 days of the preliminary approval letter, the donor must make the contribution. Within 10 days of making the gift, the donor must send proof of the gift to the Department, which will compare the proof with the preliminary approval and issue a letter of final approval of the credit.

Applications for the existing fiscal year, which runs from July 1, 2011 through June 30, 2012, will be accepted until June 30, 2012 or until the allocated credit amount of $500,000 for this fiscal year runs out, whichever comes first. As of September 13, 2011, about $63,000 of the current allotment had been used.

Should you have interest in this credit program, please contact us or one of the qualifying community foundations for more information.

Mike Harbold
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Tax Tidbits

Accelerating tax law changes. In the first quarter of 2011 alone, Thomson Reuters identified 162 changes made to state and local sales and use tax codes. Of these, 83.3% were new taxes and increases in current taxes. Tuba City, Arizona has the highest combined sales tax rate at 13.725%, well above the national average of 8.34%.

Who pays income tax? In 2009, 51% of U.S. households owed no federal income tax and the top 1% of taxpayers paid as much or more than the bottom 95% combined. However, according to the Tax Policy Center, 4,000 of those earning more than $1 million and 14,000 of those earning between $500,000 and $1 million owed no tax in 2009. Large capital loss carryovers, investments in tax-exempt bonds, large charitable contributions, and foreign tax credits are some of the reasons.

Paying the Tax Man. According to Tax Foundation, on average in 2011, workers must work 2 hours and 13 minutes of every 8 hour day to pay their share of federal, state, and local taxes. In a nine-to-five workday, taxes are not paid off until 11:13 AM. Americans would have to pay taxes until 12:07 PM for the federal government to finance its spending and balance the budget. Connecticut has the highest income tax burden, with workers working until 11:40 AM before keeping any wages for themselves. Kentucky residents finish working for taxes at 11:00 AM. Ranked 42nd, Kentucky has one of the lowest tax burdens.

Tax complexity. In the last 10 years, over 4,500 changes have been made to the Federal Tax Code. Since the last major reform in 1986, 15,000 changes have occurred. Americans spend over 6 billion hours and $160 billion per year to comply with the tax laws. Source: Roundtable Discussion on Ideas for Reforming the U.S. Internal Revenue Code, Joint Committee on Taxation, April 6, 2011

Local taxes. According to Tax Foundation, the U.S. has just under 5,000 local income tax districts. Thirty-three states have none; 9 states have fewer than 5; 3 states have between 5 and 100. The remaining 5 states account for 4,785 of the total 4,943 local income tax districts. Pennsylvania tops the list with 2,961 districts; Ohio comes in second with 774; Kansas has 535; Iowa 297; and Kentucky 218.

People News

Charles Bixler, Kelly Jowski, Nathan Plack, and **Susan Schmidt** have joined our client services team. Charles graduated from Indiana University Southeast with a B.S. in Business, majoring in Accounting. Kelly graduated from University of California, Davis with a B.A. in History, then earned her M.S. in Accounting at the University of Kentucky. Nathan graduated from the University of Louisville with a degree in Finance and then completed the Accounting Certificate Program at U of L. Susan is a Miami University (OH) graduate with a B.S. in Business and double majors in Finance and Organizational Leadership; she then earned her M.S. in Accounting at the University of Kentucky.

Jennifer Hutchinson is a new member of our support team in Louisville, serving as Front Desk Coordinator.

Tiffany Oelze also is a new member of our support team, working in Document Processing in our Lexington office.

Kerri Schwaner has joined our Human Resources group after spending about 13 years in corporate HR recruiting and management roles. Kerri holds a B.S. degree from Missouri State University.

We also welcome **Jenny Jacoby**, who has joined our support team as a business development associate. Jenny is a Centre College graduate.

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We are very pleased to welcome **Danielle Adair, Missy DeArk, Travis Frick,** and **Lance Mann** as new members of the ownership group of our firm.

Travis Frick presented “Internal Controls and Auditing Update” at the KYCPA Not For Profit Conference in August.

Melissa Hicks is serving on the Leadership Lexington Alumni Association Steering Committee.

Amelia Sebastian presented at the KYCPA Leadership Council Meeting regarding the work of the Accounting Careers Opportunities Committee.

Elizabeth Woodward and **Lance Mann** published the article “Current Trends in Accounting Fraud” in the July/August 2011 issue of the *Greater Louisville Metro Attorney at Law Magazine*.

Bill Kohm, Jim Tencza, and **Mike Harbold** presented at the inaugural KYCPA Natural Resource Conference. Their presentations were: Accounting and Auditing Issues Affecting the Coal Industry (Bill); Accounting and Auditing Issues Affecting the Oil & Gas Industry (Jim); and Kentucky State Tax Issues Affecting the Natural Resources Industry (Mike).

Missy DeArk has successfully completed the National Association of Certified Valuators and Analysts’ examination.

Susan Schmidt and **Nathan Plack** successfully completed all four parts of the CPA examination. Congratulations Susan and Nathan!

A Quotation

Here’s a quote (not from one of our technology specialists or anyone under age 40) we saw recently that might “strike a chord” with some of you:

“I have always wished that my computer would be as easy to use as my telephone. My wish has come true. I no longer know how to use my telephone.”

In Case You Missed It . . .

Our most recent e-Newsletters, listed below, are available on our website:

Natural Resources: *Major change in accounting standards relating to goodwill impairment.*
Healthcare: *The potential importance of Worksheet S-10* (Changes in Medicare cost report worksheet S-10).
Tax: *IRS surveys regarding time and monetary burdens to comply with tax law.*
Tax: *Child's summer day camp cost may qualify for tax credit.*
Tax: *IRS guidance on booster club tax issues.*
Tax: *Update - IRS tips on casualty losses.*
Healthcare: *New guidance on community health needs requirements of exempt hospitals.*
Tax: *Loss deductions for those who have experienced casualty losses.*
Tax: *Lessons from Stroff case on substantiating business expense deductions.*

If you are not now receiving our e-Newsletters, but would like to be, please email Jenny Jacoby at Jjacoby@ddafcpa.com, and let her know which category or categories of these you would like to receive (choices: College & University, Construction, Cost Segregation Services, Healthcare, Natural Resources, Not-For-Profit, and Tax) and what email address you would like to use.

The matters discussed in these articles provide general information only. You should consult with us about your specific situation before undertaking action based on such general information.

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