



Insight

A West Rhode & Roberts Publication



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SAS No. 99 — Reducing Fraud Risk

Today's business environment has become increasingly complex. This has given rise to fraud in all sizes and at every level within organizations. Fraud ranges from misappropriation of assets, minor theft and fraudulent financial reporting to hindrance of a company to reach its strategic objective. It can be hard to detect because the fraudulent party will falsify documents and collude with third parties and management. Statement of Auditing Standards No. 99 has been created for

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auditors of financial statements to report on the effectiveness of an organization's internal control used to prevent, deter and detect fraud. The government has made this standard as a guideline for organizations to follow so that they and users of the financial statements do not become victims of fraud. Since the responsibility of the organization is on the managers, they can follow three fundamental rules to prevent, deter and detect fraud. First, management should create and maintain a culture of honesty and integrity. Second, management should evaluate the risks that create opportunities for fraud and find processes that mitigate these risks. Third, manage-

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Gaming for Tax-Exempt Organizations Part I: Keeping Gaming Income Tax-Free

Funding sources for non-profit organizations go through cycles that are not in the organizations control. When funds dry up, non-profits can sometimes rely on gaming activities to get the community members together for a good time and play some fun games knowing the proceeds will go to charitable purposes. Because gaming is not a charitable activity, it is regulated under federal laws that limit the structure and impose certain taxes on the proceeds from the gaming activities. It is important to be abreast of and be compliant with these regulations because any organization's tax-exempt status can be affected by it. Exempt organizations that use gaming as a means of raising funds

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ment should develop an appropriate oversight process for all levels of the organization. If these three fundamental rules are developed fraud will be reduced.

What starts at the top will trickle down. Management should be actively engaged in creating an ethical framework that promotes high ethical standards such as honesty, integrity, trust and openness. A “zero tolerance” policy is an effective broadcast of a high ethical culture and is a statement that anything less will not be tolerated. Management should also stay away from absolute, excessive pressures on employees to meet specific goals. Instead the pressure to meet specific goals should be secondary to ethical standards. By rewarding employees for good behavior, treating all employees equally, creating a positive working environment, fostering team-oriented behaviors, adequately com-

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pensating employees and providing them with opportunities for career development, the organization will limit the motives for fraud. A goal of appropriately hiring and training the right employees and establishing consequences for fraudulent action from the very beginning of employment will ensure that the right people are working with the organization. This step will not only reduce fraud but will also make the workplace positive and productive.

Management should be actively involved in eliminating the opportunities that are presented for fraudulent activity. This is done by identifying the fraud risks, mitigating these risks and implementing and monitoring internal controls. Fraud can take place in any organization and it is management’s job to identify what kinds of fraud can happen within their industry or practice and take action to

reduce that risk. Management should develop a system of internal control that can be monitored and is commensurate with the nature and operations of the organization. For example, if management found that one employee was performing two conflicting duties and there was potential for fraud, then those incompatible duties should be separated. When an internal control is created, it’s procedures and processes should be followed at all times. Some management fall into the trap of thinking that just because an internal control is in place it is going to do its job. If a control is put in place it must be consistently followed and monitored or else the vulnerability to fraud will increase, especially if management is relying on the internal control.

Finally the organization should develop an oversight process to detect and deter fraud. An audit committee or a board of directors should be in charge of the oversight process. Sometimes it is necessary to create an independent internal auditing team that evaluates the controls in an independent fashion and reports findings directly to the audit committee or board of directors. The board/committee should actively evaluate management’s identification of fraud, implementation of anti-fraud measures and management’s ability to create an ethical and honest culture. The board/committee should all be financially literate, chartered with the responsibility to receive reports on bad ethical behavior, and should investigate fraudulent activity within its responsibilities. The board/committee should also open the door for employees to communicate their concerns regarding unethical behavior in private. Management on the other hand should be responsible for the oversight of the activities carried out by employees, financial reporting and monitoring of internal controls. The oversight is a mechanism of checks and balances that makes sure that no part of the organization is being overlooked and that proper action can be executed if fraud is detected.

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The Health Insurance Act of 2003

September 12, 2003 a bill was passed by the California legislature that requires California employers to pay a state fee or provide health insurance to their employees. October 5, 2003 this bill was signed by California Governor, Gray Davis, and is a step towards universal health care in the state of California. Although there are still issues being debated, there are a few things that employers should know.

Employers are allowed to either purchase their own plan or pay a fee to a state fund where health insurance is covered. They must provide coverage for all employees who have worked at least 3 months and work a minimum of 100 hours per month. Small employers are exempt from this law if they have fewer than twenty employees. Large firms, employing more than 200 employees, must provide insurance to eligible employees and their dependents beginning January 1, 2006. Medium firms, who employ between 20 and 199 employees, must only provide insurance to the eligible employees starting January 1, 2007.

Employers may also require their employees to pay 20% of the fee depending on their income. This amount may be withheld from the employee's paycheck. If their wages are less than 2 times the poverty level they may only be required to pay a maximum of 5% of the employers fees. Employers may also be exempt from paying the state fee if they can show that they cover their employees under a substitute plan that meets the requirements for a California Health Care Service Plan, a group health care plan, a collectively bargained health plan, a multiple welfare arrangement, health coverage provided by the University of California or any employer sponsored ERISA plan. Large companies, in addition to providing health insurance to employees, must also provide health care to the dependants of the employees.

The consequences of failing to pay the state fee will be 200% of the fee amount and even though an employer may fail to pay the fee, the employee will still be covered by the state. This means that it is important that companies are timely in paying their required fees. Employers must also keep better records of employee data to determine the amount that each individual is required to pay.

This bill has been confronted with some legal challenges, which could may effectively halt enforcement or regulations. The bill did not obtain a two-thirds majority of the California Senate and Assembly and the ERISA Act of 1974 preempts the Act. Companies should be prepared for any regulations that may come from the Health Insurance Act of 2003 and should consult with an accounting or legal professional to prepare for compliance.

Size of Employer	Effective Date	Obligation
Large Company 200 or more employees	01/01/2006	Provide qualifying health insurance to eligible employees and dependents
Medium Company 20—199 employees	01/01/2007	Provide qualifying health insurance to eligible employees
Small Company Under 20 employees	N/A	Exempt

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Any organization that is going to need reliable financial data should consider being audited by an independent auditor. The independent auditor will evaluate the organizations system of internal control and work alongside the audit committee and/or oversight board or management to ensure that controls are in place to report financial data. This will not only help prevent, deter and detect fraud, but will help the organizations performance as management is provided with reliable data to make critical decisions. If your organization has any questions on SAS no. 99 please contact our office.

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may take advantage of some rules, which permit the use of gaming as a tax-free way of raising funds. Determining whether the income from the gaming activity is included in Unrelated Business Income is the first step to operating a successful tax-free gaming activity.

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Gaming activities include popular games such as bingo, beano, lotteries, pull-tabs, Calcutta wagering, video games, 21, etc. When an organizations holds a gaming activity it could be subject to UBI (Unrelated Business Income), which is a reporting requirement for certain tax exempt organizations. When UBI is greater than \$1,000, the organization is required to file the form 990-T. If the revenues from an activity are not substantially related to the organization’s exempt purpose they are UBI. As a general rule gaming is not related to an exempt organizations tax-exempt purpose. Following are exceptions to this rule

First, certain bingo games where wagers are placed, winners are determined, and

prizes or other property are distributed in the presence of all persons placing wagers in that game, are exempt from UBI. In addition the game must be legal in that state and not in direct commercial competition with similar games held by for-profit organizations for it to be exempt from these reporting requirements. In addition, instant bingo is an exception to the bingo exception. Under a 1996 ruling, instant bingo was determined to be a pull-tab game where the winner selects a preprinted card covered with pull-tabs; therefore the proceeds from this type of game are not tax exempt. If your gaming activity does not fit under the bingo exception it may fit under the volunteer labor exception.



Some exempt organizations may operate their gaming activities with substantially all volunteer work. If your organization does, it may be exempt from the UBI reporting requirements. To test whether it does, the 85% test can be used to see whether “substantially all” the work is carried out by volunteers. If your organization passes this test it must also make sure that the volunteers are not being tipped or compensated by other means. That means if your volunteer work force is treated to a lavish dinner, then it must be included as compensation.

If your organization meets the bingo or the volunteer labor exception it can enjoy the tax-free gaming proceeds to fulfill its exempt purpose. It is important to contact your tax professional to determine if your organization is in compliance with your local and state laws. Suggested recordkeeping methods with regard to gaming income, expenses and payouts will be addressed in a subsequent article.

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