

BUSINESSES & INDIVIDUALS

POSSIBILITIES



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Health Care Reform and its Effects on Children Under Age 27

OVERVIEW

The Patient Protection and Affordable Care Act, effective March 30, 2010, extends the general exclusion from gross income for medical care reimbursements under an employer-provided accident or health plan to any employee's child under age 27 as of the end of the employee's taxable year. This article reviews what health care reform means for you and your children under 27.

employee's taxable year. This same rule will also be applicable to retiree health accounts in pension plans, Voluntary Employee's Beneficiary Associations (VEBAs) and deductions by self-employed individuals for medical care insurance.

Under prior law, the exclusion from income for medical care reimbursements was limited to reimbursements made for the employee, the employee's spouse and the employee's dependents. The rules for excluding reimbursements for an employee's child dependent required several tests; however, the Act has removed the requirements provided in the prior tests, except for age. The age test is now increased to cover any child under the age of 27 as of the end of the employee's taxable year, which can be presumed by an employer to be the calendar year.

An employee's child is defined as an individual who is the son, daughter, stepson or stepdaughter of the employee, or a legally adopted individual of the employee, an individual who is lawfully

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“We want to make it as easy as possible for employers to quickly implement ... and extend health coverage on a tax-favored basis to older children of their employees.” This comment was made by Internal Revenue Service (IRS) Commissioner Doug Shulman in response to the expanded health care coverage for children under age 27, contained in the recently enacted Patient Protection and Affordable Care Act (the Act).

The Act, effective March 30, 2010, extends the general exclusion from gross income for medical care reimbursements under an employer-provided accident or health plan to any employee's child who has not attained age 27 as of the end of the



Buy/Sell Considerations

OVERVIEW

Used properly, a buy/sell agreement is a great tool to provide direction for all kinds of triggering events that affect shareholders. Ask yourself, do you have a buy/sell agreement? Do you know what your buy/sell agreement says? How is your buy/sell agreement funded?



It may be time to pull that old agreement out of the drawer and read through it again. Buy/sell agreements may be critical to business owners considering exit planning.

For many clients, the investment in their business is the most significant financial asset they own. Our goal as trusted advisors is to help them increase the value of that asset and realize that value upon exit of the business. However, many clients either don't have a buy/sell agreement or have one that simply won't work as the shareholders expected. Some of these agreements can be "ticking time bombs!"

Ask Yourself These Three Questions:

- Do you have a buy/sell agreement?
- Do you know what your buy/sell agreement says?
- How is your buy/sell agreement funded?

We often find agreements are not current, have a price determination that isn't fair or workable for all parties and lack funding for triggering events. Those situations can result in protracted litigation and sometimes the demise of the business.

It may be time to pull that old agreement out of the drawer and read through it again. Buy/sell agreements may be critical to business owners considering exit planning. The four most common ways that business owners exit privately held businesses are to sell to a third-party, sell to employees, gift to family members or liquidate. Buy/sell agreements can provide guidance in all of these situations. Imagine each of these exit strategies and read through your buy/sell agreement to see if the language is clear and provides the results you want.

We've worked with many clients to identify trouble spots in their agreements. After working with clients through litigation and various disputes, we understand the importance of understanding how the buy/sell agreements work. Our review of buy/sell agreements focuses on three key areas: Triggering Events, Pricing and Funding.

Triggering Events

The agreement should define the process for triggering events, such as shareholder retirement, termination, death, disability, sales, divorce and bankruptcy.

Pricing

Pricing is usually defined by a fixed price, formula price or an appraisal.

Fixed Price

- Fixed prices are easy to understand.
- Fixed prices are easy to set initially, but may be difficult to reset as time passes and interests diverge.
- Provisions are seldom updated and inequities are likely to result.
- Agreements are often out-of-date when inked.

Formula Price

- Formulas provide a mechanism to update the value based on various metrics in the business.
- Formulas selected at a point in time rarely provide reasonable and realistic valuations over time.
- Changes that occur in companies, industries, local, regional, national and world economies may impact the "true value" of an enterprise relative to any set formula.
- Formulas can be misinterpreted—or are subject to multiple interpretations.

Appraisal

- The valuation process can be known by all parties at the outset.
- All parties know what will happen when a trigger event occurs.
- Parties will always know the current value for the buy/sell agreement (helpful for planning all-around).
- Appraisers can incorporate key business drivers and risks into the value.

We ask our clients to consider appraisals of their businesses. Most of our business clients have some sort of profit sharing plan, such as a 401(k). You wouldn't have a 401(k) plan that doesn't provide current valuations to participants. You pay a percentage of the plan assets to manage and account for the plan funds. Why would a company not make a small investment to understand what their business is worth with an annual or periodic valuation?

Funding

The agreement should spell out how transactions will be funded in situations where the company buys shares back from shareholders or funding the buyout of other shareholders. Management should know and have a plan for:

- Who buys the shares?
 - Other shareholders, the company or a combination thereof
 - Should the agreement consider issues with passive owners versus employee owners?
- Should the company have life insurance policies?
- Has the company considered other financial resources available to buy the shares?
- What are the terms of the transaction?
 - Down payment, interest rate, security
- Are there any restrictions on share payments under the company's loan agreements?

Other deficiencies in agreements may include the lack of signatures of all current shareholders,

the agreement has not been updated for several years, the level of value is not defined or the valuation date is not defined.

As you can see, there are a number of potential issues that could result in your buy/sell agreement being a “ticking time bomb.” Used properly, the buy/sell agreement is a great tool to provide direction for all kinds of triggering events that affect shareholders. We encourage you to discuss these matters with shareholders and your attorney. ■



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Protect the “Air:”

The Importance of Securing Wireless Networks

Wireless traffic is broadcast over the “air.” If your wireless network is not secure or poorly secured, you may be unintentionally putting yourself and your information at risk to those looking to intercept it. These risks could come in the shape of intruders just looking to leech bandwidth, or, on the more malicious side, could mask criminal activity or gain access to private or confidential corporate data.

A wireless network is a direct back door into the victim's private network and could be an indirect back door into a corporate network. In the case of a private network, most people assume they are protected by a firewall; hence they drop their guard, share drives and become careless. The intruder can take advantage of this by probing undisturbed and gain access to confidential data like tax records or work-related documents that the victim has brought home from the office.

In the case of a corporate network, an intruder can specifically target an employee of a company whose

confidential information is valuable for monetary or competitive reasons. The unauthorized user may capture data and exploit network-based resources or pose an attack, which may crash an entire network and potentially subject the organization to legal liabilities.

It is vital that individuals and businesses take necessary precautions to ensure the security of their wireless network. To ensure maximum security:

- Establish specific wireless network security policies and procedures.
- Implement physical/environmental security—ensure that guests are checked-in and escorted appropriately by authorized personnel.
- Deploy appropriate security settings for all wireless devices.
- Separate internal networks from wireless connection.

For more information about securing your wireless networks, contact your Eide Bailly service provider.

Computer Forensic Technology:

A Personal Look at Recovering the Truth

OVERVIEW

Data investigation involves searching through billions of deleted 1s and 0s on a hard drive to find the “smoking gun.” Just one piece of recovered evidence may lead to a quick settlement and less litigation costs for the client, as uncovered evidence may eliminate the need for valuable resources to be dedicated elsewhere. This article reviews the difference between data recovery and data investigation.



A friend of mine who has a master’s degree in computer science builds simulation labs for major government contractors. One simulation included a ten foot display depicting the working parts of a particular piece of military hardware in its design stage. In the display, each gear was clearly demonstrated and its movement traced to the interlocking pieces. The simulation followed the military hardware projectile as it headed downrange, over mountains, took a left at a truck, and flew into the second floor window to the target. Needless to say, it was impressive technology.

Despite her advanced knowledge of technology, when the flash card on her digital camera became corrupted, and her niece’s first birthday pictures disappeared, she asked me for help. While I was reformatting the flash card, she was thoroughly convinced the pictures had been irreversibly lost. A few minutes later, the forensic software I was using recovered all the pictures of a one-year old enjoying her first birthday cake. A long discussion of “How did you do that?” soon followed. Computer forensics was outside her knowledge base, even with her intense background in computer technology.

When I entered the private sector of computer forensics, the Federal Rules of Civil Procedure outlined the policies and procedures for the retention and archiving of data, e-mail, voice messages and similar electronic records. In my work, I found that companies and law firms were content to pay for data recovery as it related to litigation cases, but seldom for data investigation. Why? Because few understand the difference between the two processes.

Let me explain. Data recovery encompasses the retrieval of lost data. Data Investigation, on the other hand, is true computer forensics and involves searching through billions of deleted 1s and 0s on a hard drive to find the “smoking gun” that can help a client continue to fight or decide to settle a case. Data investigation in civil litigation typically involves the search of archived data for key words relating to the case

and can account for a very large part of the investigation.

One of the first cases I worked on in the private sector related to the difference between data recovery and data investigation in a civil litigation case. The case involved a property claim and palimony agreement of two individuals who both held high-level positions at the same company. When I entered the investigation, a considerable amount of time and money had already been spent by the client on “computer forensics,” which amounted to data recovery and, therefore, no conclusive evidence.

I was asked to examine a computer not yet reviewed using data investigation methodologies. My examination revealed spoliation of the computer’s files, which implicated the company’s IT manager as part of the plot to delete and scrub the data files. The investigation findings included the exact time and date in which the IT manager scrubbed, or removed, the data files. These time and date stamps indicated that the IT manager scrubbed the files the same evening it was documented that he spent the night at the petitioner’s home ... an interesting case finding. In this situation, the IT manager knew how to delete and scrub data, but he did not know that computer forensic technology would be able to uncover his actions.

The use of data investigation methodologies can uncover more than just changed time and date stamps, and can be used for more than civil litigation. The following examples showcase the variety of evidence computer forensics can uncover and the many different situations where data investigation can be utilized:

- A rapid settlement without further litigation costs was reached when the data investigation of a company proved that employees with non-compete clauses in their contracts had downloaded the company’s strategic plan, customer lists and pricing strategies onto a CD one day before resigning.

- A sexual harassment case was successfully defended by a company when deleted e-mails containing attachments in violation of the company's acceptable use policy were recovered from the petitioner's account. Other deleted e-mails also helped the company's case; some of the recovered e-mails had been deleted more than four years prior to the recovery.
- A deleted e-mail containing the words, "I'm not going to jail over this!" was recovered while performing computer forensics for a fraud case. This e-mail would not have been found or recovered using only the key words provided by the attorneys. A good computer forensics examiner will use his experience, as well as information from the client, to create a preliminary plan for the analysis.
- Computer forensics can assist in divorce litigation. Through computer forensics, a plot discovered in a common chat file indicated that one respondent was concealing assets through a third-party. In another case, the character of one party was quickly tarnished in a custody battle when copies of e-mails that were submitted to the court as exhibits and purported to be genuine were found to be questionable and fraudulent.

Businesses and individuals can benefit from understanding data investigation methodologies and what they are capable of uncovering. Data investigation should not be viewed in the same light as data recovery, but instead, should be viewed separately as an investigation to locate evidence supporting or disputing a claim relating to civil or criminal litigation, divorce, human resources or other types of issues.

In any litigation, a sound plan on how to use electronic discovery is important. Determine if the case requires only data recovery or the use of computer forensics. A plan to investigate data must be fluid, as each new piece of evidence may lead the case in a different direction. One single e-mail, deleted years ago, may lead to a quick settlement and less litigation costs for the client, as uncovered evidence may eliminate the need for valuable resources to be dedicated elsewhere.



Most importantly, companies need to understand the extent of information that can be recovered and investigated through computer forensics. Like my friend's pictures, data that is seemingly lost forever can be recaptured. To recover lost documents efficiently and effectively, it may be useful to enlist the help of an IT specialist. A computer forensic examiner, on the other hand, may be more valuable in data investigation to uncover documents that could be important to proving or disputing a claim. With the help of the right person, lost photographs of a child eating birthday cake and deleted e-mails that could help solve a case are not gone forever ... they are just waiting to be recovered. ■



The use of data investigation methodologies can uncover more than just changed time and date stamps, and can be used for more than civil litigation.



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How to Prepare for an IRS Examination

OVERVIEW

An Internal Revenue Service (IRS) examination can be a stressful situation. This article outlines the actions steps you should take in the event of an IRS audit.

The anxiety begins as you pull the envelope out of your mail box and see it was sent from the Internal Revenue Service. Anything from the IRS sets off all sorts of emotional responses, most of which are not good. But, in reality, this event, and those related events that may follow, usually isn't as serious as the images your mind generates. It all depends on what you have done to prepare for this eventful day and the action steps you have put into place to deal with it.

An IRS examination may come in two forms. The first type includes the IRS requesting to see you in person to discuss one or more items on your filed tax return. The second type, which is used much more frequently, is by correspondence; the IRS sends you a letter asking for supporting information, or tax due (or both), and the taxpayer responds.



Unfortunately, taxpayers forget that just because they received a notice that their tax return has been selected for an examination action, or audit, it doesn't mean their return is wrong. It simply means their return has raised a question, due to either presentation format or facts presented.

If you've received a notice that says the IRS wants to have a visit with you, or they've made a review of your return information and believe you owe additional money, you may be thinking, "now what?"

If you are comfortable corresponding with the IRS by telephone or in writing, follow the instructions in the notice you received. Keep in mind, this may not be the best course of action, because regardless of how much you try, your emotions will get in the way, particularly if the amount of potential examination adjustment is

large compared to the original tax shown on the return. Therefore, we suggest you contact your tax advisor to assist you.

Preparing for an IRS examination, or state examination, begins with the information used to prepare the return being examined. Think of it this way, anything on the return is subject to questions regarding why it was reported. Are you capable of answering questions related to the return if raised during an examination?

To answer the potential questions that could be asked on examination, make sure you retain the originals, or copies, of the various Form 1099s received related to dividends, interest and other items of income or expense you received from others. In addition, any transactional items such as contracts for the purchase or sell of property, compensation agreements and Forms K-1s from partnerships, Subchapter S corporations and trusts should be retained. If you made a summary schedule of itemized deductions that was provided to your paid return preparer, or that you used to personally prepare the return, for medical, taxes, charitable contributions or miscellaneous type deductions, be sure to retain the detail so if asked to substantiate the deduction during an examination, the detail to the summary information is available.

You may be wondering how long to retain your tax records. Most importantly, retain the cost basis records, transactional documents and proof of purchase price for property at least until the year or years that the property is sold, plus four years. Items that provide support for a deduction or income reporting item should be retained for four years. This period will allow you to clear the normal three-year statute of limitations timeframe during which the return could be examined, except where fraud is involved.

Taxpayers are ultimately responsible for the tax returns they file. Utilizing a professional paid preparer will not give any assurance that a return will not be examined, but if an examination does occur, the paid preparer is the person with knowledge about how the return was prepared, and should be a resource in the examination process. A certified public accountant (CPA), or

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other qualified person, can represent the taxpayer in an examination; the taxpayer will need to provide the CPA with Form 2848 - Declaration of Representative Power of Attorney for the period(s) under examination. This will allow the CPA to stand-in for the taxpayer in discussions with the IRS and perform other duties as authorized by the taxpayer.

IRS correspondence examinations have increased due to electronic filing of returns by individuals and the digital record-keeping and filing requirements related to Forms 1099. By having electronic information available, the ability of the IRS to match records received from independent sources to the return information reported by a taxpayer has greatly increased, giving rise to more correspondence examinations. Therefore, it is extremely important that all Form 1099s and K-1s received by a taxpayer be provided to his/her paid tax preparer, or used by a taxpayer in filing a self-prepared return. Otherwise, a taxpayer can expect the IRS to send a notice about the difference, particularly if there is a tax liability calculated on the unreported difference. Be diligent in the assembly of tax information used in a return prepared by a professional or self-prepared; diligence is one of the best ways to reduce the chances of a correspondence examination by the IRS.

If your next trip to the mailbox includes a little surprise from the IRS—don't panic. With the proper supporting documentation at hand and a knowledgeable CPA, you will be ready to meet the challenge of an IRS, or state return examination. ■



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On May 1, 2010, Eide Bailly accepted nine staff members into its partnership, bringing the total number of partners/principals* to 167. Join us in congratulating the following individuals:

Rhea Hemish, CPA, Mankato partner, has more than 14 years public accounting experience with a focus in financial institution taxation and consulting.

Frank Gariepy, CPA, Denver partner, has more than 30 years experience serving clients in variety of industries, including real estate development and construction, manufacturing and high-tech startups.

Allen Gregory, CPA, MT, Denver partner, has more than 22 years public accounting experience working with middle-market companies and their owners and executives.

Dave Glennon, CPA, Fargo partner, provides assurance services for SEC, manufacturing and insurance clients. He joined Eide Bailly in 2000.

Jeremy Bendewald*, CFE, CFI, MBA, Fargo principal, serves as director of Eide Bailly's Forensic Accounting and Investigative Services.

Ryan Doyle, CPA, Sioux Falls partner, specializes in audit and accounting services for a variety of industries, including ag processing, renewable energy, general business and manufacturing.

Susan Hanson, CPA, Sioux Falls partner, has more than 15 years public accounting experience providing services to a variety of industries, including employee benefit plans, real estate, wholesale and retail distribution and individual and corporate taxation.

Kelley Grace, CPA, Norman partner, provides accounting services to a variety of industries, including auto dealerships, high net worth individuals, real estate development, manufacturing and construction.

Keith Osborn, CPA, Norman partner, provides consulting services to clients, focusing on tax, estate, gift and retirement planning. He also provides accounting services to financial institutions, high net worth individuals and oil and gas clients.

Also on May 1, 2010, **Victor Puchi** joined our Phoenix, Ariz., office as partner. Victor previously served as managing partner and CEO of R&A CPAs in Tucson, Ariz. Please join us in welcoming Victor to Eide Bailly!

Visit our website at www.eidebailly.com/news to view the complete news release.

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RETURN SERVICE REQUESTED

Health Care Reform—from page 1

placed with the employee for a legal adoption or an eligible foster child, defined as an individual who is placed with the employee by an authorized placement agency or by judgment, decree or other order of any court of competent jurisdiction. And, there is no requirement that a child meets the definition of an employee dependent; therefore, a child could be married and still meet the definition of a child.

The effective date of March 30, 2010, allows employers to permit employees to immediately make pre-tax salary reduction contributions for accident and health benefits under a cafeteria plan for children under age 27, even if the cafeteria plan has not yet been amended to cover these individuals. However, the employer is required to make a retroactive amendment to a cafeteria plan for children under age 27 no later than December 31, 2010. The amendment must be effective retroactively to the first date in 2010, when employees are permitted to make pre-tax salary reduction contributions to cover children under 27, but in no event before March 30, 2010.

There is an important distinction between the child under age 27 coverage of a cafeteria plan and a group health plan, because the Act did not amend the Public Health Service Act, and applicable Internal Revenue Code

Sections, dealing with group health plans, in the same manner as cafeteria type plans. For a group health plan, the age change was to apply to children under age 26 and will be effective for the first group health plan years beginning on or after September 23, 2010, which in some cases would not make the change effective until 2011. But the IRS and Treasury, seeing no indication that Congress desired different ages to be used, intend to amend the age requirement under the Internal Revenue Code that controls group health plans to retroactively change the age test to be under age 27, not under 26. The application effective date for the group plan to years beginning after September 23, 2010, is not anticipated to be changed.

The Act does not require an employer to provide employee dependent coverage. Check your plan specifics before assuming automatic coverage. If you have questions regarding health care reform and how it affects you, please contact your Eide Bailly tax professional. ■



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