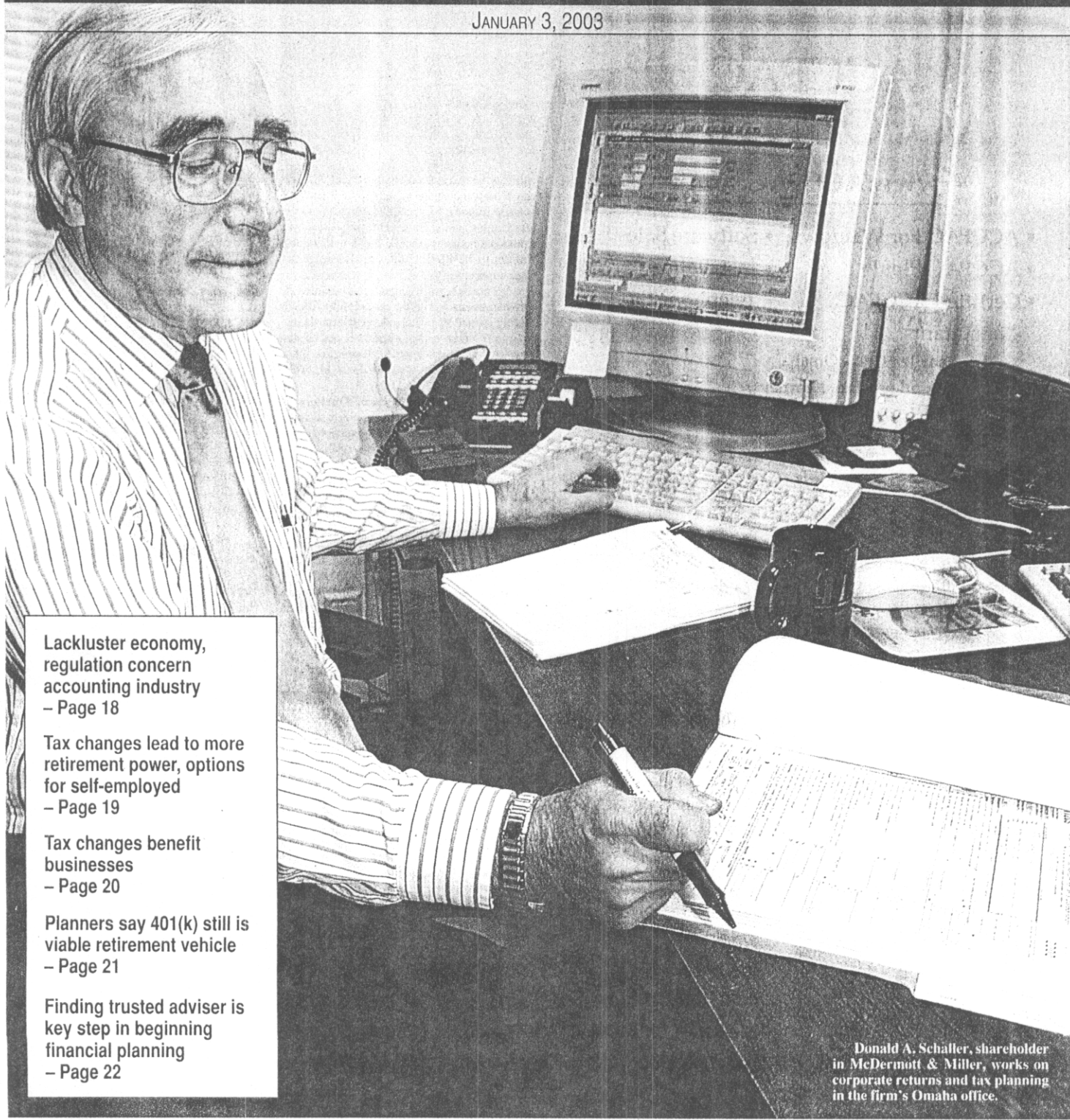


A SPECIAL FOCUS SECTION

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Donald A. Schaller, shareholder in McDermott & Miller, works on corporate returns and tax planning in the firm's Omaha office.

Lackluster economy, regulation concern accounting industry

by David Kubicek

A lackluster economy in which clients are less willing to engage in large consulting projects and increased regulation, spurred by recent accounting audit improprieties, are the two major challenges the industry has faced over the past year and will continue to face going into 2003.

"We hope the economy will turn around

over the next year," said David Baysinger, tax manager at Lutz & Co. in Omaha. "In some areas we're seeing a reverse, but people generally are hesitant to make any big changes in their expenditures."

For things to turn around, there would have to be an increase in the confidence level, backed up by some solid revenue, and clients would need to see a rebound in the markets for their

specific businesses, he said.

"We're continuing to look for ways to improve our clients' cash flow and to be profitable in trying economic conditions by minimizing expenditures and income taxes," he said.

The Sarbanes-Oxley Act of 2002 puts sig-



Baysinger



Ham

nificant restrictions on what services accounting firms can provide to their audit clients, primarily limiting SEC clients' auditors to only performing audits. Some of the provisions were to become effective Jan. 1, 2003, with various others to be implemented at future dates, Baysinger said.

"After the terrorist attacks there were some provisions enacted on the tax side allowing for an additional 30 percent depreciation deduction in the first year a property is placed into service," he said. "That is effective for property placed into service from Sept. 11, 2001, through 2004."

Don Ham, audit partner at BKD in Lincoln, said some regulations are in process to substantially increase the government oversight of the accounting industry, and that may spill over into other industries.

"The Public Accounting Oversight Board and regulations are being formalized to limit what kind of services we can and can't provide to public clients," he said. "I do lots of work with the banking industry, and there might be some spillover to some larger private banks in the future."

Ham said BKD's Lincoln branch handles private companies, so it isn't seeing as great a call for regulations as those who handle public clients, but the firm still is getting lots of questions about what it could mean to the industry.

"Those problems are creating too much

alarm in the business sector," he said. "Insurance costs are going up dramatically."

The accounting industry lags behind others when the economy shifts, Ham said.

"When the economy begins heading down, things continue to go well for us for a little while, and when the economy starts improving, there is a delay for us," he said. "When the economy isn't doing well, clients look at professional fees more, and jobs may be put up for competitive bids although they might not have been if the economy were doing better. Special projects might be delayed another year until times are better and companies can afford to do them."

An ongoing issue is the lack of people entering the accounting profession.

"The demand has outstripped the supply for some time, and that won't turn around immediately," Ham said.

Although the Sarbanes-Oxley Act is for public companies, some think restrictions may filter down unofficially, if not officially, to some of the larger private companies. They might decide to follow the rules for public companies because they may go public themselves someday, Ham said.

"There's some alarm, which may be an overreaction, among firms that Sarbanes-Oxley doesn't apply to and may never apply to," he said.

Potential impacts of the legislation, such as an increase in insurance rates or a restriction against firms providing their audit clients with non-audit services, would make it necessary for accountants to look closely at what they are charging for audits and tax services to make sure they're being properly reimbursed, Ham said.

Roger Thompson, audit partner at Seim Johnson Sestak and Quist in Omaha, said the industry faces the challenge of regaining the integrity and the respect that accountants historically have had, some of which was lost as the result of media discussion of recent high-profile failures.

"First we must abide by ethical standards," he said. "Although it's not always required, I believe all people who call themselves CPAs should take a certain amount of ethics training annually to keep it in the forefront of their minds."

"In addition, we need to return to the basis of being an auditor — skepticism. We can't listen only to what management tells us and accept it; we must verify discussion points with external sources."

"In an age of trying to get things done as quickly as possible, we rely too much on management representation rather than getting third party verification."

Thompson said auditors and accountants always must remember who they are serving. For consulting projects they usually are serving management, but for auditing they are serving the board of directors and shareholders.

"We need to better inform the public about what we do," he said. "In some instances the public thinks we look at every detail, but that's not true. We need better communication from our professional societies, and when we talk to boards as auditors we must have a better discussion of what our responsibility is and how we accomplish it."

Thompson said he believes the audit process needs to be retooled. Although time is being spent to provide fraud detection and controls, processes also need to be developed to audit management overrides of controls.

"Management override is an area of fraud, and fraud probably is the most difficult thing to

Continued on next page.

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Tax changes lead to more retirement power, options for self-employed

by Karen Campbell Burmood

As hectic as owning your own company may be, retirement is one thing all self-employed people should keep in mind. Tax breaks made in 2001 have given the self-employed higher contribution limits on retirement accounts.

"The 2001 tax changes increased the limit of retirement plans for both companies and the



Morrison



Nosal



Elliott

self-employed," said Jane Morrison, a tax partner at BKD.

Optimal retirement plans for the self-employed can vary, depending on an individual's specific needs.

A traditional Individual Retirement Account is logical for people looking to contribute under \$3,000 annually, because that money is sheltered.

Les Nosal, president of Nosal Professional Group, said if a self-employed person is 50 or older, the new tax law allows a catch-up feature of an additional \$500 a year. That means someone 50 or older can put away \$3,500 in the IRA annually.

"If you have more than \$3,000 that you would like to invest, say up to \$10,000, a simple IRA usually works pretty well," Nosal said. He said there are several advantages to setting up a simple IRA. The most important is that people are not required to file complex paperwork with the Internal Revenue Service.

One disadvantage is that if a self-employed person has a day job and is participating in a 401(k) plan through that company, the maximum annual employee contribution that can be made between the simple IRA and the 401(k) is \$11,000.

"With respect to the simple IRA, there are higher contribution limits if you are 50 or older," Nosal said. "Part of this is because the government is trying to encourage people to save for retirement. It was a common complaint of those close to retirement age that the limits were too low, so they raised them."

A Simplified Employee Pension is another alternative. Such plans can be ideal for a small business owner who has employees.

"The 2001 tax breaks raised the contribution limits for SEPs," Nosal said. "Before, if you wanted to save up to \$40,000, you would have to use a definite benefit plan, which can be complicated and costly to maintain." Morrison said one key difference between an SEP plan and other plans is that funds are fully vested for all employees, which is an added incentive for self-employed people with a staff.

"One of the reasons a company does a pension plan is to provide benefits to employees and to keep them wanting to work for you," Morrison said. "Plans other than SEPs can have vesting schedules, and funds may not be available for employees when they leave. Through SEPs, funds are immediately available for employees when they leave."

According to John Elliott, president of

Boyle Hess & Elliott, there are now one-man 401(k) plans, also referred to as uni-401(k) plans or solo 401(k) plans, thanks to favorable changes in the Economic Growth and Tax Relief Reconciliation Act of 2001. These allow considerably larger annual deductible contributions because people are allowed two different kinds of contributions.

"Business owners can contribute up to 100 percent of their self-employed income or compensation up to a limit of \$11,000 for 2002 or \$12,000 if the owner was 50 or older as of Dec. 31, 2002," Elliott said. "The solo 401(k) plans also allow a second contribution of up to 20 percent of self-employed income or 25 percent of

compensation."

Patricia Anderson, a partner in McDermott & Miller, said this type of plan works particularly well for a self-employed person with no employees or perhaps those who just employ their spouse.

"As an example of how this plan would work, if a self-employed person had a profit from the business of \$100,000, he could have a salary deferral of \$11,000 and an employer match of \$18,680, for a total contribution toward retirement of \$29,680," Anderson said.

Nosal tells his clients that it's important to build wealth outside of their company through a retirement plan.

"Many self-employed people look to the potential amount they will sell their business for as their retirement fund," Nosal said. "It's important to start a retirement plan as a way to supplement what money they get when they sell their company."

Since most self-employed people concentrate on their business, Elliott said, it can be difficult to be an expert on each and every vital issue, such as wise retirement options.

"It is extremely important to develop a plan with your financial adviser that addresses your long-term needs, that can be reviewed on an annual basis and that does not depend on hitting overly optimistic investment results," Elliott said.

Accounting industry

Continued from preceding page.

detect in an audit," he said.

Thompson said the General Accounting Office in the spring of 2002 issued new independent standards with provisions similar to Sarbanes-Oxley. In an attempt to make sure auditors don't provide substantial consulting services, the GAO has limited those services to 40 hours or fewer.

"That will have a greater impact on smaller rather than larger firms, especially those that serve government entities like school districts," he said.

The Nebraska Society of CPAs, along with the Board of Public Accountancy, is working on a legislative rewrite of Nebraska's Public Accountancy Act, a process which many states already have gone through.

"That may not have an impact on how we conduct our audits, but it might affect what requirements people must have to call themselves CPAs," Thompson said.

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Tax changes benefit businesses

by Sherry Thompson

Businesses can benefit from several tax changes, including the Tax Relief Act of 2001, which came about as a result of 9-11.

The bonus depreciation for assets acquired or constructed after Sept. 11, 2001, is one of



Wilson



Baas



Riggs

the most significant tax changes for 2002, said Ray Wilson, tax partner with Deloitte & Touche.

"The government is giving businesses a 30 percent depreciation bonus right off the top for anything acquired after 9-11, kind of an incentive to go out and spend money," Wilson said.

The business gets the first-year allocation of depreciation, plus 30 percent. For a five-year asset, the business normally would get 20 percent of the cost basis in the first year. With the

bonus depreciation, the 30 percent comes off the top — \$3,000 for a \$10,000 asset. The 20 percent first-year allocation would then be taken on the remaining \$7,000, Wilson said.

"You get more than double what you used to get," he said.

Another change is there is no alternative minimum tax preference for bonus depreciation items.

"That is a good thing," Wilson said. "Otherwise, bonus depreciation might have thrown the business into alternative minimum tax."

C corporations filing 2002 tax returns can take advantage of another rule that was imposed about 9-11, the ability to carry back net operating losses for five years.

"The normal rule is two years," Wilson said. "What Congress did was allow taxpayers who incurred losses because of the economy and 9-11 to carry back those losses and recapture the taxes they paid in the preceding five years."

While this rule expired Dec. 31, taxpayers can use it on 2002 returns.

"This has been a huge item this year be-

cause of the economy," Wilson said. "There are lots of companies that are losing money this year, and they are able to get a cash benefit immediately out of those net operating losses."

Elimination of the alternative minimum tax net operating loss limitation also was enacted following 9-11. Previously, when net operating loss was carried back, it would offset alternative minimum tax income up to only 90 percent.

"Now you can totally offset it," Wilson said. "This goes along with that five-year net operating loss carryback."

Retailers may benefit from new regulations concerning the last-in first-out (LIFO) inventory method. There are new rules for the use of simplified LIFO that could create a big benefit for retailers, Wilson said.

A tax case resulted in a change in how prepaid assets are handled. The decision hinged on the one-year rule dealing with the deductibility of prepaid items such as insurance, Wilson said. While the IRS said prepaid assets could not be deducted, the appellate court said they could.

"It is a big issue because a lot of companies pay their insurance for years that do not correspond with their tax years," Wilson said.

If, for example, insurance was paid for the year beginning in November, the company would pay 10 months of the next year's insurance. What the court said is that you can deduct that on this year's taxes, Wilson said. Previously, the IRS would let the business deduct only two months the first year and the remaining 10 months the next year.

"What the court has said is that as long as the policy does not exceed a year, you can deduct it," Wilson said. "It is a good ruling for taxpayers."

Other changes include Treasury Circular 230 which eliminates the contingent fee arrangement for accountants who practice before the IRS and their clients.

There's also a new structure of penalties and a new definition of tax shelter. The penalties are more onerous and the disclosure requirements are more rigorous.

Some businesses can automatically switch from the accrual basis of reporting to the cash basis, said David Baas, president of Baas and Associates. While this change came about in 2001, further changes were added in 2002.

In 2001 the IRS said it would allow automatic change from the accrual basis of reporting to the cash basis for certain small businesses that had annual gross receipts of more than \$1 million but less than \$10 million and were C corporations. However, the business could not have average receipts for the last three years of more than \$5 million.

"In 2002, the IRS expanded that law to say

if a business had more than one activity, if the activity generating the largest percentage of gross receipts was a permitted activity, typically a service business, that business could change to the cash method for the entire business reporting," Baas said.

"The IRS also said that if a business maintained a complete and separate set of books for each activity, it would use the cash method on the qualifying activity, even if it was not the principal business activity."

If, for instance, a plumbing business sold fixtures in a store and more than half of its gross receipts came from sale of fixtures, the business in the past was obligated to report on the accrual basis of accounting. That meant the business paid taxes on accounts it had billed for plumbing work done, even though payment had not been received.

"In general, the accrual basis will cause a larger taxable amount," Baas said. "The IRS now is softening its stance on companies up to \$10 million and allowing them to make an automatic changeover to the cash method."

"There are some very favorable income tax effects when one changes from accrual to the cash basis," he said. "They can get a one-time benefit in the year of the change, plus, in general, we believe it will reduce the taxable income in future years."

Changes also occurred regarding health insurance reimbursement. Previously, the Section 105 plan allowed businesses to reimburse employees for their medical expenses, Baas said. The reimbursement was deductible for the business and nontaxable for the employee, if it was done on a nondiscriminatory basis.

Under this plan, the employer indicated the maximum amount of reimbursement at the beginning of the year. If the employee's medical expenses that were not covered by insurance were less than this amount, the balance that was not reimbursed disappeared.

A new ruling says that, if an employer sets up a Health Reimbursement Arrangement, the employer can carry over for the benefit of the employee the portion that was not reimbursed and can use it for future years' expenses for reimbursement to the employee.

If an employer said he would reimburse a maximum of \$1,000 and the employee had \$200 of medical expenses reimbursed in 2002, the \$800 the employer could have paid carries forward.

"You could add it to the \$1,000 and now have up to \$1,800 that could be reimbursed the next year," Baas said. The balance carries forward and can be used even after the employee retires.

In Nebraska, changes in sales tax regulations are affecting many businesses.

"Not only did the sales tax go up Oct. 1, but it expanded what is subject to sales tax," said Gary Riggs, manager of Phillip A. Waldron CPA. Riggs is chairman of the taxation committee of the Nebraska Society of CPAs.

Services which now collect state sales tax include vehicle washing and waxing, vehicle painting, vehicle towing, security services, pest control, building cleaning and maintenance, computer software training, installation and application labor, and labor for option for contractors.

The definition of what is maintenance and what is repair is not always clear-cut, however.

"If you charge for labor services to maintain a piece of equipment, sales tax is collected," Riggs said, "but if you provide labor services to repair that same piece of equipment, it is not subject to sales tax. You can see where it might be difficult, as a contractor might be doing both

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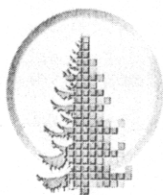
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Planners say 401(k) still is viable retirement vehicle

by Lea Pounds

Despite recent volatility in the stock market, 401(k) plans still are a good vehicle for retirement planning. Contributions to a 401(k) are deducted from a person's salary before taxes, lowering the amount of taxable

funds garnered from investment decisions."

A 401(k) plan grows without incurring taxes, and even though taxes will be due when the participant starts to withdraw funds, the tax rate most likely will be lower at retirement.

"People have lost sight of what a 401(k) plan is all about," said Mark Genereux, owner of Genereux Investment Management. "It's investing for the long term and shouldn't be expected to double every year."



Bauer

Another benefit of the 401(k) plan as a retirement vehicle is the flexibility of the financial products offered. Participants can develop a mix of products to fit their risk tolerance. Options range from conservative investments with guaranteed returns to more aggressive growth oriented portfolios.

Mutual of Omaha's retirement plans division takes a portfolio approach.

"This gives participants the opportunity to achieve the growth they want," said Ryan Bauer, vice president of Mutual's retirement plans division. "The participants decide the risk level they're comfortable with, and the counselor helps them make decisions about what mix of investments is right for them."

Typically, 401(k) plans are constructed so participants are given a wide variety of

choices, and the investment consultant provides education on how to invest.

Studies conducted by Mutual of Omaha show that 50 percent of plan participants don't want to shoulder all the responsibility for making investment decisions. Most want help from a professional.

It's a question of time rather than intellect, Bauer said. Plan participants don't want to take the time to research all the options. They prefer to have a professional help guide their investment decisions.

When first conceived, 401(k) plans moved the burden of planning to the employee, compared to defined benefit plans like pensions where the employer carried the burden. Changes in the regulations governing employee benefit plans will allow employers to hire in-house investment advisers to help employees with their retirement planning decisions, Genereux said.

Diversification options are offered through plans like Mutual of Omaha's Mu-

tual Directions benefit plan. Most plans allow mixed investments so employees can choose from a broad range of options.

"We walk individual participants through their risk tolerance and time horizons and then help them choose the portfolio mix that meets their needs," Bauer said.

Investment consultants who use the portfolio approach can focus their educational efforts on investing for the long term, which is the best investment strategy for retirement planning.

The system for retirement planning is broken only in the sense that people aren't saving enough, Genereux said. If an employer provides 3 percent matching funds and the employees invest only enough to get the matching funds, they're not saving enough to meet their goals.

Portability is an advantage to 401(k) plans. Workers, especially younger ones, are changing jobs as a means to career advancement rather than working their way up the corporate ladder in the same company. Their

Continued on page 23.

income and improving the tax situation.

The ability to invest pretax dollars is one benefit to 401(k) plans.

"For example, if a person making \$25,000 a year in a 20 percent tax bracket contributes 6 percent to a 401(k) and the employer matches 3 percent, the tax deferral feature of a 401(k) saves \$300 in taxes," said Ellie Anderson, wealth adviser at Carson Feltz Wealth Management Group.

"At 6 percent the person is contributing \$1,500 a year. But when you consider the tax savings, the actual out of pocket is \$1,200. Combining the employee investment with the matching employer funds nets a yearly investment of \$2,250.

"And that's before the addition of any

Tax changes

Continued from preceding page. services."

On the federal level, the IRS has been more aggressive in enforcement efforts concerning whether compensation that closely-held corporations pay owners and officers is considered reasonable.

If a C corporation pays owners too much, the IRS may say it is disguised dividends, and dividends are not deductible by the corporation. The company would owe taxes if the com-

ensation is declared to be dividends, which are also taxed at the individual level.

Professional corporations pay a flat 35 percent tax rate. The IRS may say not enough wages were paid, and an increase in wages means additional FICA taxes are collected.

On a personal level, the IRS is gearing up to conduct compliance audits that could include looking at flow-through income from businesses, Riggs said. Notifications began in December for audits to be conducted in January, he said.

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