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Growing Your Business™

Volume 56 . 2008

Anti-fraud, one size does not fit all*

*connectedthinking

PRICEWATERHOUSECOOPERS

The loss of consumer confidence related to a fraud incident can be devastating.

Volume 56 . 2008

Growing Your Business is published by the Private Company Services (PCS) practice of PricewaterhouseCoopers. It is focused on providing privately-owned business owners and management with PCS's point of view, guidance and insights on issues affecting their businesses and personal wealth.

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All businesses need to protect revenue and reputation from the potentially devastating effects of fraud. PricewaterhouseCoopers' Biennial Global Economic Crime Survey found that companies with both ethical guidelines and compliance programs report suffering fewer acts of fraud and other crimes.

However, as businesses change, reach across geographic boundaries or their employees become determined to outwit internal controls, management must review fraud-risk management programs to ensure they remain effective. Employees trained to spot fraud, deter and prevent it can be powerful allies. Featured is an eight-step program for fraud-risk assessment.

Protecting your financial health and reputation

Every business needs to protect its financial health and reputation from the potentially devastating consequences of fraud and other forms of misconduct. And, according to PricewaterhouseCoopers' fourth biennial Global Economic Crime Survey released in 2007, "Economic Crime: People, Culture and Controls," many businesses could be doing a better job of guarding their money, property or legal rights. More than half of the 500 US companies surveyed report having been affected by economic crime. Crime, such as fraud, not only could cost in terms of revenue, it could also harm a company's reputation and even cause its collapse.

Though companies are likely to have at least some level of controls in place, and procedures to minimize fraud risk, they are still subject to fraud if controls are inadequate or become so as businesses change or employees learn to work around procedures. And private companies, which typically are less likely than their public counterparts to have effective anti-fraud programs and controls, can be reluctant to report and prosecute fraud for fear of adverse publicity.

"A challenge, for many private companies is working out how to strike the right balance between having *enough* trust in employees so they can thrive and having *too much* trust, which would provide opportunities for fraud," observes Jeff Able, a PricewaterhouseCoopers' Private Company Services partner.

The extent of activities required to evaluate fraud risks at a company should be commensurate with the size and complexity of its operations and financial reporting environment. Such risk assessment efforts are proving worthwhile. The 2007 Survey found that companies with both ethical guidelines and compliance programs reported suffering fewer economic crimes.

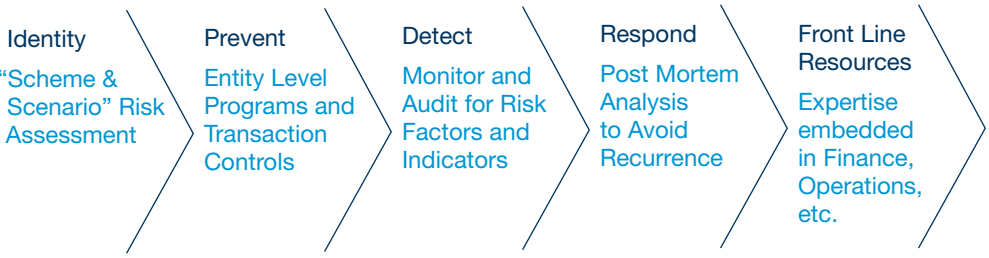
A detailed focus on improving business controls has the added benefit of potentially improving the company's operating effectiveness and stopping revenue leakages, such as providing services below normal pricing, failing to use proper pricing codes and offering credit to unqualified customers. Businesses could be better able to fight fraud by educating employees on how to help prevent, deter and detect it. "Employees are the eyes and ears of private business," says Bill Warren, a director of fraud risk and controls with PricewaterhouseCoopers' Advisory Services group. "If something is amiss, they are likely to know about it before management or the company's auditors."

Focus on the transaction level

While the Global Economic Crime Survey found that the level of damage appears to be directly proportional to the seniority of the perpetrator, fraud at this level occurred in only about 29 percent of the companies surveyed. This underscores how important it is to go beyond entity-level anti-fraud controls and set priorities for addressing possible issues at the business process or transaction level. The foundation of fraud prevention is the division of responsibilities between employees. The reason is straightforward: It is one thing to steal by yourself but quite another to collude with a coworker.

Often, private companies say they lack sufficient personnel for an efficient checks and balances system. However, a simple step, such as ensuring that the same employee who approves vendors doesn't have the authority to write checks, can help reduce fraud risk. The close-knit company that believes fraud "can't happen here" and allows the same employee to approve vendors, sign checks and reconcile the bank statement and keep its books is an easy target.

What practical steps might a company take to defend against internal and external misconduct?



How well does the company unlock company information to identify what could go wrong?

How well does the company leverage risk assessment process to reinforce local accountability?

How efficient is the assessment process, e.g., are the businesses asked to do more than one assessment?

How well does the company address vulnerability to management override of controls, collusion among employees and/or third parties, or other forms of collusion when designing preventive controls?

How well does the company tailor detection procedures to key risk factors and indicators?

How well does the company maximize existing information systems to prevent and detect misconduct?

How well does the company learn lessons when misconduct is detected? Does it analyze root cause, extend audit procedures to root out other misconduct?

How well does the company embed fraud and misconduct expertise at the "front line"—does it over rely upon the "second line", e.g., compliance, ethics, internal audit, legal?

Not only must businesses have preventive measures in place, it is essential that they continue monitoring them for effectiveness. “Companies without internal audit departments, or personnel serving in that capacity generally lack a process for periodically determining if the anti-fraud controls management believes to be in place are designed appropriately or operating effectively,” Able notes.

Many fraud risks and the opportunity for misconduct differ from company to company and industry to industry and need to be considered when developing internal controls. For example, a business in the construction industry would be expected to have controls in place to prevent employees from bribing public officials to win large contracts. Not only does bribing a government official for a contract risk prosecution of both individual and employer by the US Department of Justice, if it takes place overseas, it is also subject to the Foreign Corrupt Practices Act and the foreign country’s local laws. On the other hand, retailers and consumer products manufacturers must guard against damage to their brand and reputation. The loss of consumer confidence related to a fraud incident can be devastating.

Where to begin

A sound risk management program not only takes into account industry-specific issues, but is also designed in light of the company’s current operations and longer-term strategy.

First, a company must review its compensation programs and performance evaluation process to identify potential incentives and excessive performance pressure such that employees resort to fraud to make their numbers. This review considers how meeting—or not meeting—financial reporting targets potentially impacts an individual’s evaluation, compensation and continued employment.

Then, management conducts a fraud risk assessment to identify various other ways that fraud and misconduct can occur throughout an organization. It sets priorities for addressing areas subject to a higher risk of fraud. [See Eight-Step Program for Fraud Risk Assessment on page 6.]

While evaluating and testing the design and operating effectiveness of entity-wide anti-fraud controls, there’s no substitute for thinking like a fraud perpetrator seeking to override them. A very good summary of what private companies should consider when developing a fraud-risk management program, the “COSO: Guidance for Smaller Companies Principle 10—Fraud Risk,” was created by the Committee of Sponsoring Organizations of the Treadway Commission.

Watch out for new risks

As a business grows and adds new locations and new vendor relationships, someone independent of the day-to-day operations should reassess controls in place to ensure they are still designed and operating effectively, revisiting questions such as: Can someone set up a fictitious vendor? Does the person who reconciles cash accounts also have access to the general ledger? And, other key questions targeted to the business. In emerging markets, the 2007 Survey found that 61 percent of parent companies that employed different accounting systems than those of their subsidiaries, reported they were more susceptible to fraud, compared to 52 percent that operated a unified system.

Two faces of fraud

You might think of fraud as actions that cost an organization directly, such as embezzlement, accepting bribes or kickbacks or intentionally concealing or misrepresenting events, transactions or data. However, fraud can be designed seemingly to benefit an organization for the direct or indirect benefit of the perpetrator, such as to gain a management bonus or promotion.

According to guidance strongly recommended by the Institute of Internal Auditors, *Practice Advisory 1210.A2-1: Auditor’s Responsibilities Relating to Fraud Risk Assessment, Prevention, and Detection,* examples of fraud designed to benefit the organization include:

Improper payments, such as illegal political contributions, bribes, and kickbacks, as well as payoffs to government officials, intermediaries of government officials, customers, or suppliers.

Intentional and improper representation or valuation of transactions, assets, liabilities and income, among others.

Intentional and improper transfer pricing (e.g., valuation of goods exchanged between related organizations). By purposely structuring pricing techniques improperly, management can improve their operating results to the detriment of the other organization.

Intentional failure to record or disclose significant information accurately or completely, which may present an enhanced picture of the organization to outside parties.

Sale or assignment of fictitious or misrepresented assets.

Intentional failure to act in circumstances where action is required by the company or by law.

Intentional errors in tax compliance activities to reduce taxes owed.

Prohibited business activities, such as those that violate government statues, rules, regulations or contracts.

Any business reaching across borders for clients, acquisitions, suppliers and investors, must monitor its internal controls to maintain integrity in the face of different cultures and legal environments. And, like US laws, the laws in other countries are subject to change. “In recent years, several large companies have had significant compliance issues because they were not keeping up with the changing laws,” observes Warren.

In the grand scheme of day-to-day business, how important is appropriate fraud-risk management? Is it worth the time and expense to ensure that an employee cannot misappropriate as little as $400 without calling attention to it? “It depends,” says Warren. “If that employee is using the $400 to bribe a foreign official to win a contract it could cost the company far more in fines, penalties and investigative costs.”

Don’t underestimate the power of a tip hotline, even if it’s just an e-mail address. The most common way that 60 percent of the businesses in the 2007 Survey say they discovered fraud within their organizations was by accident, or a tip from another employee.

While it may not be possible to eliminate the risk of fraud altogether, with proper planning, policies and procedures, and controls in place, your company can minimize the risk of serious fraud, and at least detect fraudulent activity early and minimize its damage. A comprehensive fraud risk management program also should include an incident response and remediation process to address allegations or suspicions of fraud or misconduct.

An 8 step program for fraud-risk assessment

1
Assemble a fraud-risk assessment team. Make sure the team is broad and deep enough. For example, a vice president of one business area might understand a risk in theory, but someone on the factory floor is more likely to better understand how things are actually processed.

2
Decide on scope, framework and deliverable. Are you interested in financial statement manipulation, asset misappropriation or other criminal activity? At what level does it become material to the company? How detailed should controls be? How are you going to gather information, rate your risks and map risks to controls within your organization?

3
Identify inherent risks. Consider risks without regard to existing controls to avoid relying upon ineffective or inefficient controls.

4
Assess likelihood and significance of risks. Significance depends upon the nature of the risk, e.g., a potential fraud scheme may be inconsequential to the financial statements, but very significant to the company’s operations.

5
Link significant risks to transaction controls and evaluate the controls. Don’t overlook design effectiveness—a control may be adequate to protect error, but vulnerable to override, collusion or other intentional circumvention.

Want to know more about creating a robust fraud-risk management program? Please contact:

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Need additional guidance?

The following publications provide greater detail on creating and maintaining effective internal controls to prevent fraud and other significant risks in the financial reporting area.

Coso: Guidance for Smaller Companies Principle 10—Fraud Risk

2007 SEC Guidance Regarding Management's Report on Internal Controls over Financial Reporting

IIA Practice Advisory 1210.A2-1: Fraud Risk Assessment, Prevention & Detection

Statement on Auditing Standards No. 99 Consideration of Fraud in a Financial Statement Audit

6
Share residual risks with business unit and process leaders. Because business leaders are accountable for misconduct in their unit or process, provide them an opportunity to decide which risks for which they accept responsibility (non-residual risk) and those for which they are unwilling to accept accountability—because a preventive control is deficient or not practical.

7
Develop remediation plan, for example, proactive anti-fraud audit procedures to address risks when red flags occur. Require the business leaders, working with finance, to develop a remediation plan to reduce risk to an acceptable level by either enhancing preventive controls or focusing on early detection.

8
Perform fraud auditing and monitoring as needed. Re-engineer the risk to identify potential red flags. Design auditing and monitoring procedures to detect and follow up on key risk indicators.

Does your fraud-risk management program pass the test?

Evaluate your fraud-risk management savvy using the Anti-fraud Program and Controls Assessment Grid at www.pwc.com/gyb

Transfer pricing isn't a new area, but it's relevant now more than ever—companies are on the move around the globe, and tax authorities across state and international borders are imposing new documentation requirements, assessing stricter tax penalties and increasing information exchange and audit activity.

Intercompany pricing strategies affect the bottom line in ways you might not expect

When related parties are in different countries or states, tax authorities want to ensure that profits won't be artificially shifted from a higher-tax jurisdiction to a lower one. Businesses also have an interest in ensuring that profits clearly reflect the division of functions, risks and assets employed between the parties. However, many companies consider transfer pricing (TP)—how a business prices intercompany transactions—to be too costly a burden, to simply avoid potential tax compliance penalties. They also frequently think of transfer pricing as only relating to pricing for goods and services.

But TP goes beyond the pricing of goods and services, and effective TP policies provide multiple benefits that go beyond penalty avoidance. "An effective transfer pricing policy is a strategic tool," says Bill Seeger, a transfer pricing principal with PricewaterhouseCoopers in Dallas, "not a tax compliance item. It's really about using business acumen and about determining how to use effective pricing and planning to save money."

What is transfer pricing?

Transfer pricing is a term used to describe all aspects of intercompany pricing arrangements between related business entities. Seeger points out, "Transfer pricing is not just about the transfer or sale of tangible property. It also applies to services, leasing, loans and loan guarantees, other financing transactions, and transfers of intellectual property. Transfer pricing applies to any intercompany transaction between different tax jurisdictions, whether across state or international borders." TP applies to both domestic and international related-party transactions, and is designed to prevent tax avoidance among related entities due to differences in rules and rates between jurisdictions and to place parties under common control on parity with unrelated taxpayers.

a and b are related parties in different tax jurisdictions.

Differences between jurisdictional tax rules and rates create the opportunity for related entities to shift income from a higher tax jurisdiction to a lower tax jurisdiction. Tax authorities of course attempt to source as much taxable income as possible in their respective jurisdictions.

What is "arm's length?"

The arm's length principle is usually applied by comparing the "conditions" (e.g., price or margin) of a controlled transaction with those of independent transactions. Guidelines allow the use of inexact comparables that are "similar" to the controlled transaction but not the use of "unadjusted industry average returns." Some factors to consider when assessing the comparability of a transaction include:

The specific characteristics of the property or services;

The functions that each enterprise performs, including the assets used and, most importantly, the risks undertaken;

The contractual terms;

The economic circumstances of different markets (for example, different countries, wholesale versus retail); and

Business strategies (for example, market penetration schemes when a price is temporarily lowered).

In the US and most other developed countries, a proper transfer price for a transaction is one that two independent parties, dealing "at arm's length," would agree upon. The resulting price is called an "arm's length price" and the arm's length principle is a cornerstone of the TP methodology used in most countries.

Setting transfer prices may seem simple in theory but can be complex in practice, since it can be difficult to obtain sufficient information to apply the arm's length principle as defined by tax law.

In the US, TP tax rules are governed by Internal Revenue Code section 482, which gives the IRS the right to reallocate certain income and expenses between related parties doing business in different jurisdictions. In 1968, the IRS issued regulations that provided rules for applying the arm's length standard. However, new temporary and proposed regulations were issued in 2006 that change the rules substantially in the area of intercompany pricing for services and intangibles. The changes apply to a wide range of activities. Seeger notes that "businesses are now required to charge for such activities as management services, back-office services, marketing and selling services, supervisory expenses and R&D services. There are also new rules requiring pricing for intangibles."

In addition, the IRS is tightening up the cost-sharing regulations. "Companies were moving economic rights income from intangible property offshore, to low-tax jurisdictions, and selling from there—and the tax dollars were not coming back to the US," says Seeger. "Midsize companies that have entered into a cost-sharing arrangement should look closely at these temporary and proposed regulations as they are modified."

The sleeping tigers are awake

Revenue authorities have, in general, become much more aggressive in the TP arena over the last few years, and there has been an increase in both the number and intensity of transfer pricing audits in the US and abroad. "We are also seeing penalties being assessed more frequently, and the complexity of the issues and arguments has also generally increased," says Seeger.

The IRS is looking more deeply at intercompany pricing issues. For example, an IRS directive issued in 2003 requires agents to request contemporaneous TP documentation (i.e., documentation prepared at or near the time the transactions take place) from multinationals and to perform more than a cursory review of these reports. As a result, multinational entities should expect to be asked for adequate documentation on how they set their intercompany prices and why the result is arm's length, as part of the standard review of their US tax returns.

In addition, the IRS now has extensive resources available for field audits, at the appellate level, and in competent authority procedures, including agents specially trained in economic analysis. Transfer pricing audits are not limited to cases where avoidance is suspected.

States are also taking a harder look at TP issues for companies with operations that cross state boundaries within the US. One point of focus for the states has been interstate intellectual property issues, and, in recent years, several states have enacted legislation disallowing expenses for various intercompany intangible property transactions, including technology royalties, trademarks, trade secrets, and other expenses relating to intangible property.

In addition, in many states, management service fees payable to a related party have become disallowed expenses to the extent that they involve any embedded intangible assets or nonroutine services where it is difficult to benchmark the market value.

FASB Interpretation No. 48 (FIN 48) also has an impact. Seeger points out that "along with increased scrutiny by the IRS is a mandatory deeper look at transfer pricing structures for FIN 48 purposes. Businesses must have adequate documentation to support the position that no reserve is required for FIN 48 purposes, and now auditors are required to review transfer pricing documentation for FIN 48 reserves."

The problem of penalties

A major and growing problem for the executives of multinational companies is the issue of preparing documentation to demonstrate compliance with TP rules, both in the US and abroad.

In the US, the section 482 regulations provide wide and strict rules for documentation of TP policies. Taxpayers can no longer avoid documenting the arm's length character of their TP. If they do, they run the risk of substantial penalties. "The IRS is now applying penalties that have statutorily existed for a long time," explains Seeger. "In the past, agents failed to impose them with any sort of consistency. Now, if an agent is not assessing penalties when appropriate, they must internally justify why. Companies must now have adequate documentation."

What does proper documentation look like?

Most countries' transfer pricing documentation requirements vary to some extent. However, as a general guide, a defensible transfer pricing policy requires documentation in the following areas in order to demonstrate how the policy complies with the arm's length principle:

A description of the transfer pricing policy;

Guidelines interpreting the policy;

Inter-company legal agreements;

Functional analysis of the entities involved;

Comparables supporting the policy;

Financial analyses; and

Industry evidence required to substantiate the decisions made.

The US is not the only country taking action. More and more countries have established—and are now enforcing—documentation rules for TP policies. This is a particular challenge, since each country typically expects something slightly different in the way of documentation.

Going global—transfer pricing often catches private companies by surprise

A company should establish a defensible TP policy when it first begins to carry on part of its business on a cross-border basis. Any more limited objective inevitably gives rise to later difficulties.

"Ironically, some of the most complex transfer pricing issues I've tackled have been with private companies," says Seeger. There are a number of reasons why, though many problems are the outcome of inadequate attention to TP when a company first begins to go global. He points out, "For example, pricing policies may not have been adequately thought through… they may be set on-the-fly or based on inconsistent criteria, or company leaders may erroneously think mid-size or private companies are exempt. Or, at the beginning, intercompany transactions may be small and the business may be hesitant to invest the necessary effort in establishing the policy. Or, when people hear 'documentation,' they think it has something to do with filing tax returns."

Seeger adds, "Regardless of the reasons, what begins on a weak foundation grows into a larger, weaker framework, and an IRS audit is often the wake-up call. Unfortunately, at that point, a company not only faces penalties, but also potentially large costs to disentangle the pricing arrangements, figure out what should be done, and implement appropriate and effective transfer pricing policies."

In addition, TP policies are not purely about taxation. For example, unless properly addressed, TP policies can affect management behavior where managers are remunerated by a bonus linked to local company operating profits. Another area often overlooked is the effect of transfer prices on indirect taxes. For instance, the movement of goods across international borders often gives rise to a customs duty liability. These effects must be considered as part of an effective TP strategy.

An ongoing process

Putting in place a well thought-out TP policy up front is essential, but an effective process isn't a one-time event. To maintain its value, the policy must be reviewed on an ongoing basis. For example, an initial TP policy may not reduce the effective worldwide tax rate. Apart from the difficulty in devoting sufficient resources to pricing and planning when developing new markets, it's difficult to predict accurately how the overseas operations will progress in terms of sales and expenses.

Many different events may require re-thinking of a TP policy, for example:

- A change in business operations or risks, including exchange risk
- A change in the operating structure of a company
- Parent company desires or pressure
- Changes in law

The sometimes-hidden benefits of planning

Appropriate TP policies and documentation are necessary to meet compliance requirements and avoid penalties, but "transfer pricing has more than a compliance objective," says Seeger. "Companies need to ask: 'how can we use it to benefit the position of the company?' " A transfer pricing analysis cannot only reduce taxation and avoid penalties—it can also help a company identify which activities are (or are not) performing well—and can uncover pricing policies that are inadequate for financial purposes.

For example, a company that is incurring losses in the US may discover that it is not charging royalties for intellectual property, or it may discover that the US is providing administrative services to related parties in other countries without charging out the costs. Seeger points out, "Clients sometimes ask, 'can we use transfer pricing to get cash into the US?' The answer is yes, if current transfer pricing policies are not correct. The regulations allow you to make adjustments," says Seeger, "as long as there is an arm's-length result. For instance, a client who was seeking to bring cash back to the US discovered that its transfer pricing prices were too low. Transfer prices were raised so that an appropriate amount of revenue was earned. In addition, they had millions of dollars of central administration costs that had not been adequately allocated abroad."

Another example of a planning opportunity is one that can arise as a company's R&D activities move to different locations. "After a while, nobody knows who's sharing what or with whom" says Seeger, "or, commercially viable R&D may be in a high-tax jurisdiction. There may be no coordinated R&D or intangible property policy. The TP rules allow companies to think about the most effective way to benefit from investment in R&D or marketing structures such as principal vs. agent, or licensee vs. licensor. A good transfer pricing policy will look at licensing options and legal and economic ownership arrangements."

Seeger concludes, "Tax authorities will continue to develop more sophisticated related-party regulations and tighter enforcement mechanisms. The right amount of transfer pricing effort can pay off in the form of a more stable tax charge, coupled with the ability to defend a company in the event of a tax audit. "When businesses don't take a good look at transfer pricing issues," he says, "they leave money on the table. Appropriate transfer pricing can bring dollars to the bottom line."

Reduce the risks, increase the benefits

Risks of an inadequate transfer pricing process:

- Increased local tax liability
- Potential double taxation
- Penalties and interest for inadequate documentation

Benefits of a proactive TP process:

- A properly designed, implemented, and monitored process can:
- Reduce the above-cited risks
- Reduce a group's worldwide tax burden
- Uncover opportunities for properly assigning profits and cash to meet business goals
- Keep pricing policies up to date with tax and other legal changes

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The widespread availability of affordable high-speed wireless technology, compatible devices and software applications has made Enterprise Mobility, or EMobility, feasible for significant business processes. EMobility could make it possible for an organization to open its business model to alliances and innovation. However, the challenge is to understand potential benefits for customers and suppliers and tailor solutions to specific needs.

Are you moving toward an enterprise-wide solution?

As quickly as you could say "text message," the next wave of opportunity in the business operating environment is upon us. Enterprise Mobility, or EMobility, offers alternatives for interacting with customers, employees, assets, and other businesses—any time, from any location. Though the concept has been discussed since the advent of the Internet, it has become feasible only since high-speed wireless technology and compatible devices became readily available and affordable. Today, software applications can be installed on smaller, less-costly hand-held computers and used for significant business processes. Essentially, the combination of pervasive mobility applications, services and connectivity could add up to the opportunity for true enterprise mobility for most businesses. No exploration of how an EMobility solution could benefit your business would be complete without pausing to consider the potential impact of being trumped with one by your major competitor.

"The challenge for businesses is to understand the potential opportunities that EMobility could provide to them, as either a customer or supplier, and determine how to move quickly to benefit," says Christopher Isaac, PricewaterhouseCoopers' Advisory Services principal.

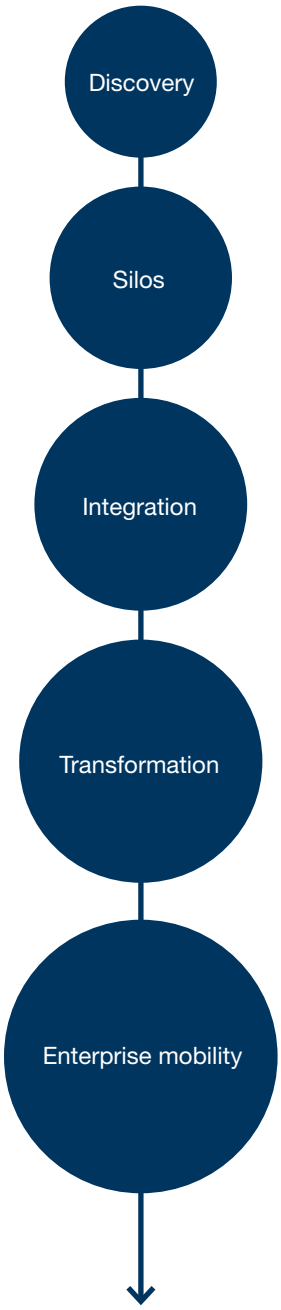
"Unlike e-mail, which all sorts of businesses could adopt readily, EMobility must be tailored as part of a solution for specific situations," notes Adam C. Kennedy, Advisory Services director. "A solution that might work for a shipping company is not necessarily right for a financial services company or a utility company because each has a different set of needs. For example, a utility company might want to use a wireless device to dispatch repair and maintenance crews and coordinate service calls with customers. On the other hand, a solution for a financial services company with far-flung offices could be more about ensuring that customers have access to a central repository of secure information in real-time."

We recently spoke with Kennedy and Isaac to discuss how EMobility is being integrated into business models to encourage alliances and innovation.

Q What do midsize businesses need to know about EMobility?

A EMobility is not just about buying technology, it's about finding ways to improve your business using mobility technology as a tool to facilitate alliances and innovation, for example managing inventory using radio frequency ID chips, providing secure access to a central repository of information, or managing a field workforce more effectively using devices that let you know where they are and where they need to go.

EMobility evolution—stages and benefits



Stages	Benefits
Discovery	Elimination of paper-intensive processes
Silos	Immediate access to information on perishable decisions First-mover advantage through fast time to market
Integration	Seamless data sharing from BU to BU Improved customer service through bundled services Business partnerships driven by tighter collaboration Focus on core business maintained through best-of-breed vendor partnerships
Transformation	Real-time customer management/faster response times Up-selling/cross-selling opportunities through tighter collaboration Increased efficiencies through automated mobile event management Reduced customer churn through perceived technology competitive advantage
Enterprise mobility	Lower lifetime cost of ownership with modular, scalable platform Anytime, anywhere mobile e-commerce enables new channels
	Cost reduction/productivity Increased revenue Customer experience

Q What are the potential benefits of using EMobility effectively?

A Three major benefits could include:

- Cost reduction/increased productivity
- Increased revenue, or
- Improved customer experience

However, rarely would a company get all three benefits at once. Typically, in developing EMobility, companies generally pass through five stages of evolution, although in practice, some companies skip directly to more advanced stages and reap the benefits of prior stages. [See chart on page 16.]

Q How has the use of mobile technology changed over the past three years?

A Three years ago, early adopting industries, such as technology and transportation/logistics, led the market in implementing mobile applications for specific business functions, such as handheld units for delivery personnel. Today, companies that are deploying mobility solutions tend to target individual business processes and functions within a specific area of responsibility. Successes are driving more businesses to create company-wide mobile strategies that incorporate current infrastructure, demands from different parts of the business including clients and IT strategy.

Q Where does EMobility appear to be headed over the next few years?

A Increasingly, businesses will consider using mobility to innovate and re-engineer business processes to harness the full potential of legacy or concurrent IT investments. We're already seeing vendors creating enterprise-wide solutions rather than discreet applications. I would think core enterprise products with out-of-the-box mobility can't be far behind.

Q How could enterprise technology change the way a business deals with vendors and customers?

A Here are just a few examples. Suppliers could seek solutions that make them appealing as preferred vendors, for example, using radio frequency ID chips in product packaging to facilitate product tracking by distributors. On the client side, the ability to exchange information on a real-time basis can be a powerful tool for connecting customers quickly with information they need and want, customizing it for how they would like to receive it. For example, a timeshare tour could comprise a more interactive, multimedia experience tailored to a prospect's interests, such as skiing in Canada versus surfing at the beach in Hawaii. Or, a utility company that employs a new "Smart Meter" technology could change its entire business model, from one that requires sending someone to read your meter to one providing real-time information about electricity use, giving the company the power to adjust power during peak and non peak hours. A California utility company is implementing this type of technology today.

Q What's the first step toward enterprise mobility?

A Assessing your business processes and determining where the opportunities are in those processes that mobility will facilitate.

Q What does an enterprise need to consider when implementing a mobility solution?

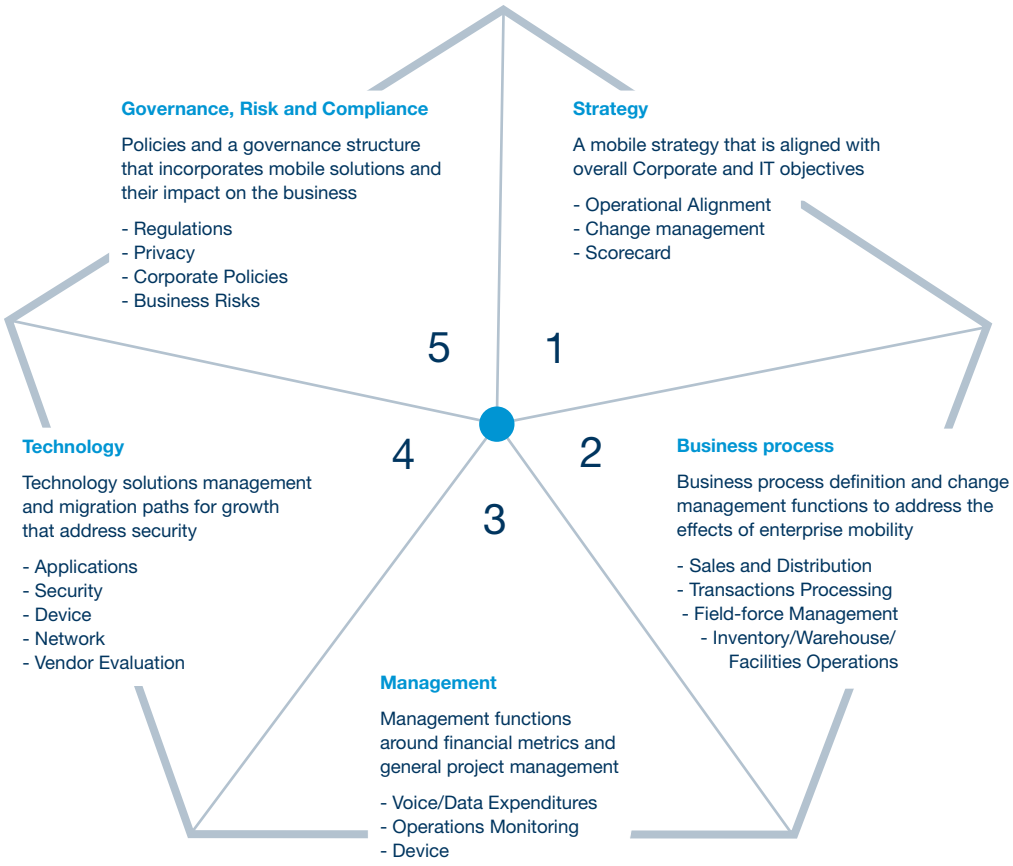
A A business should consider the following five key items in the diagram below when implementing a mobility solution.

Q What might surprise a midsize company about enterprise mobility?

A Implementing enterprise mobility solutions might not be as costly as you think. Just as cell phone use prices have dropped, general technology prices tend to come down as technology matures. It all depends on what you need and you can start with a small, pilot project and grow. For example a small brokerage house could offer a group of select customers access to financial data and market information on PDA devices to notify them of market changes and confirm shares bought or sold.

Q What is the biggest risk of EMobility?

A Among the greatest risks is allowing what used to be well-protected data, such as confidential information, to move outside of corporate walls without effective security, governance and compliance.



As the number of success case studies mounts, we are starting to see greater momentum around EMobility, and with it, more expectations around consumers and suppliers for instant access to information.

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by independent feature writer Janice K. Mandel, mandel.schneider@erols.com

Risk hot spots

Areas to watch for risk on the path to enterprise mobility include the following:

1 Strategy

Mobility strategy that is not consistent with the overall stated corporate objectives or IT objectives could result in ill-fitting technology or technology that does not adequately support the underlying business issues and processes.

Mobility initiatives may lack executive support, leading to unrealized benefits, cost overruns, and poor decision making.

2 Business process

Integrating mobile processes with existing business processes, replacing existing business processes, and changing organizational structures require significant resources and commitment from the top down. As a result, the enterprise may under-support mobile initiatives and prevent a full realization of benefits that produce positive value, such as the creation of new business models, increases in operational effectiveness, or enhancements in customer experiences.

Lack of strong project management may lead to deployment delays and cost overruns, and could inhibit benefits realization.

3 Management

Cost and return on enterprise-wide EMobility implementations may be difficult to quantify because processes have unclear performance indicators and demand is difficult to test until applications are implemented. As a result, inconsistent frameworks may be used to evaluate, monitor, and measure the performance of mobility solutions.

4 Technology

Poor vendor selection and management practices may slow the success and adoption of new mobile solutions. For example, the selected vendors may not provide the necessary customization of applications and devices to meet business needs.

If available technology is a driving force for adoption, the enterprise may lose its focus on business processes and purchase unneeded or ill-adapted technology.

5 Governance, Risk and Compliance

The company may inadvertently violate security, privacy, or regulatory policies because of a weak EMobility policy and governance structure.

A focus on solutions for individual business units or functions may produce overlapping expenditures.

Every business owner needs to plan ahead to protect the family wealth through proper estate planning as part of an overall business plan.

With talk of Congress leaning toward a compromise on repealing the estate tax law by freezing the amount of the estate tax exemption amount at $3.5 million, repeal seems unlikely. Now is the time to reevaluate your estate plan.

What to count on when estate tax repeal is uncertain

If you have been watching for signs that the federal estate and gift tax system might settle down since Congress instituted changes in 2001 with the Economic Growth and Tax Relief Reconciliation Act, the next few years could be filled with transitions, and a good time for business owners to keep their estate plans in order.

"It's best not to assume that the estate tax, which included gradual reductions in transfer tax rates and increasing exemptions—such as on gift tax and generation-skipping transfer (GST) tax—through 2010, will be repealed in the near term," observes Evelyn Capassakis, PricewaterhouseCoopers' Private Company Services principal. "Though planning in a changing tax climate can be a challenge, it is essential for business owners—as part of their overall business plans—to protect their family wealth through proper estate planning."

Though there has been uncertainty over whether or not the estate tax law would be repealed in 2011, when the tax law is scheduled to return to its 2001 state, it sounds as if Congress is leaning toward a compromise to repeal. A possibility that is gaining traction is to freeze the amount of the estate tax exemption at $3.5 million, which it is scheduled to reach in 2009. Keep in mind that there is no proposed change to the gift tax exemption, and to the extent that exemption is used during life, it reduces the amount of the estate tax exemption remaining and available at death. [See chart below.]

Guide to the current tax law and exemptions through 2011
Year-by-year transfer tax rates and exemptions

Year	Estate tax exemption	GST tax exemption	Gift tax exemption	Highest estate, GST, and gift tax rates
2008	$2 million	$2 million	$1 million	45%
2009	$3.5 million	$3.5 million	$1 million	45%
2010	n/a (taxes repealed)	n/a (taxes repealed)	$1 million	35% (gift tax), 0% (estate and GST tax)
2011 and later	$1 million	$1 million	$1 million	55%

Proper estate planning should be an important part of every business owner's overall business plan. Business owners seeking to make the most of their legacy need to engage in basic estate planning activities that enable them to accomplish their goals most effectively.

"Most taxpayers can accomplish significant estate planning objectives simply by taking advantage of lifetime gift-giving," says Capassakis. "This includes making maximum use of the annual exclusion, making lifetime use of the gift tax exemption, and making lifetime taxable gifts."

Three top lifetime gift-giving techniques for business owners

Three top estate planning techniques that business owners can employ in the current environment are 1) making annual exclusion gifts, 2) passing along appreciation in assets through Grantor Retained Annuity Trusts (GRATs), and 3) providing descendants access to assets through a trust.

Making annual exclusion gifts

One of the most frequently overlooked or misused techniques is the annual exclusion gift. If you've got a large family, you can transfer significant amounts of wealth simply by making annual exclusion gifts. Every taxpayer can transfer up to $12,000 per year to as many donees as they wish, free of estate, gift and GST taxes. Annual exclusion gifts can be made to minors by using a Uniform Transfers to Minors Act account under applicable state law, or through a minor's trust that meets the requirements of the Internal Revenue Code.

Top three estate planning mistakes

Successful business owners tend to be shrewd planners, but when it comes to estate planning, there are areas in which it doesn't pay to push the limits. Following are three top estate planning mistakes:

1. Cutting corners and skipping the formal valuation when making a gift of a business. "If the valuation used for gift tax purposes is found to be incorrect, then the gift would use part of and reduce the gift tax exemption or could be taxable if it exceeds that amount," says Capassakis. "However, given the change in the gift tax statute of limitations there may now be greater certainty with respect to valuations."
2. Trying to retain voting or other control after giving away trustee powers either by imposing some kind of family partnership or keeping strings on a trust. This control may bring the transferred business value right back into the estate.
3. Running personal finances through the business, such as borrowing money, after giving away ownership. Again, this causes the IRS to argue that the business should be included in the estate of the owner, on the theory that the business was never really given away.

For example, suppose you have three married children and five grandchildren. Giving $12,000 to each of these 11 donees totals $132,000. By getting this amount out of your eventual estate, you would save $59,400 in estate taxes if you are in the 45% estate tax bracket. If you make annual exclusion gifts in each of two calendar years, you can transfer $264,000, for a $118,800 tax savings. "You are also transferring out of the estate the growth in value of the asset after the date of transfer," notes Capassakis. Depending on how young you are, the growth on the assets can be quite significant.

If your spouse is also a US citizen or resident, you can double the gifts. If you and your spouse elect on a timely-filed gift tax return, you can treat the gifts as made one-half by each of you, thereby doubling the benefit. In the example above, you would be able to transfer $528,000 over two years. "It's important to note that you and your spouse must consent to split all the gifts made to third parties by either of you during the year, not just annual exclusion gifts." For example, in a year where you elect to split gifts you can't make a significant gift to heirs that uses up some of your lifetime exclusion without also using up some of your spouse's. You can't pick and choose which gifts you split and which you don't.

Passing Asset Appreciation through Grantor Retained Annuity Trusts

A favorite technique for transferring appreciation in assets to heirs continues to be the Grantor Retained Annuity Trust, or GRAT. A GRAT is a trust to which the grantor transfers assets and retains the right to a specified annuity from the trust for a set term. At the end of the term, assuming the grantor has survived, the assets pass to or in trust for the grantor's specified heirs and are not included in the grantor's estate. If the grantor does not survive the term, part or all of the trust assets may be included in the grantor's gross estate.

The GRAT is particularly attractive for grantors with an interest in a closely held company that may be sold, either via a public or private sale. If the grantor transfers a minority interest in the company to a GRAT prior to the sale, it might be possible to value the company taking into account a minority interest and lack of marketability discount. Once the company is sold, usually at going concern value, with a commensurate premium, rather than a discount, the often-significant appreciation could pass directly to the beneficiaries instead of becoming part of the business owner's estate.

"It is important that the transfer does not take place too close in time to the sale or initial public offering so that the IRS does not argue that the appreciation has already taken place, and value the gift at the sales price," notes Capassakis. How close in time is "too close" depends on the facts, but if there is a written sales agreement, it is probably too late.

Providing access to assets through a trust

Another way to keep gift tax and estate tax from eating up significant value of the business that you wish to pass along to descendants, but not actually giving it to them outright, is to give them access to assets in an ordinary trust. Often a business owner's greatest asset is the business itself, and the owner might not have assets with which to make annual exclusion gifts. If this is the case, you can put stock in an ordinary trust and give beneficiaries withdrawal powers, known as *Crummey* powers after a 1968 case on this matter known as *Crummey v. Commissioner.* As with the GRAT, transferring a minority

interest in the company to an ordinary trust prior to selling your business might make it possible to value the company at the time of the gift by taking into account a minority interest and lack of marketability discount.

Doing this, and combining the gift with your annual exclusion gifts, makes the strategy very powerful.

If you use the annual exclusion to make gifts of property other than cash, such as an interest in your business, minority interest and lack of marketability discounts could be available that allow you to transfer a greater interest in the business using the same annual exclusions, than you would be able to transfer if you were not able to avail yourself of discounts. Say you have a 30% combined discount for lack of marketability and minority interest. Then, over four years you and your spouse would be able to transfer $1,500,000 in value of a business. Assuming a 30% discount, the value is reduced to $1,050,000. Then, this interest could be transferred using $525,000 of the same $528,000 of cumulative annual exclusions over two years, as described above. Over 10 years, you could transfer over $3,750,000 in business interests, using just the annual exclusions. This is a much more powerful result than giving the beneficiaries $12,000 in cash each—even assuming the cash was available, and you were so inclined.

In addition to the annual exclusion amount, to the extent the gift tax exemption is used during life by giving away stock of the business, any future appreciation on that stock also escapes estate and gift taxation.

Planning as part of business strategy

As a business owner, when determining who will benefit from your assets and how, you must take into account practical considerations such as:

- Are you concerned about who will run the business after you retire or are deceased?
- Is it important that the business remain in the family? If so, will you arrange to transfer control of the business over your lifetime to save on estate taxes?
- Will you need the business to provide cash flow for your retirement without sacrificing family control?
- Will there be provisions made to protect long-term employees or customers?

Want to know more about estate planning? Please contact:

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