# *Mistakes Well Worth Avoiding*
## *By Chris Burand*

An article I authored regarding the importance of annual accountants' reviews sparked a lot of emails from agents sharing their experiences about having their agencies audited. Stories ranged from one agency that discovered an employee was embezzling funds, to another that learned their long-time bookkeeper (who happened to be a partner) was totally incompetent at keeping books. Others shared simple but large mistakes, some were in the agency's favor and some against it. In every case, correcting the problem greatly benefitted the agency. Some agents reported that nothing was found, but the audits helped them sleep better.

I also noted in the same article that many agency owners mistakenly believe their tax accountant is checking for accounting problems. However, unless you specifically ask your accountant to audit your books, he or she most likely is not. Many agents voiced great surprise that their tax accountants were only considering their agency's tax consequences and not their overall financial health. I think many felt downright deceived. Keep in mind though, communication is the key to establishing an optimal relationship with your CPA. Many private business owners only tell their CPA's, "Lower my taxes." So the CPA's do. Many agents never hold a conversation with their CPA about their financial needs or discuss finding a balance between minimizing taxes, adequately funding their trust account, and building their agency's value.

Some agents must make a conscious decision to pay more in taxes in order to build agency value. Paying too little in taxes often has the unintentional consequence of decreasing agencies' values because by taking all the profits out of the corporation, to minimize taxes, the agency becomes undercapitalized. Almost all undercapitalized agencies are also out of trust, an even more serious consequence. Just to reiterate why being out of trust is so serious, first it is illegal in some states. Second, it is a violation of some company contracts. Third, it is in my opinion (though I am not an attorney) very close to fraud because an agency has spent a client's money on something other than its intended use.

Being undercapitalized also often means not having the money to adequately invest in the agency's future. In the past, this was less important and usually limited to automation systems. Even then, many agencies lost considerable profit by waiting too long to purchase the appropriate system. Now agencies need more capital for training and hiring key employees, especially producers.

Undercapitalized agencies take another hit, often very large, when they are sold. This is because undercapitalized agencies are worth significantly less (to smart buyers at least) than adequately capitalized agencies.

Agencies that are formed as something other than "C" corporations seem to be especially prone to being undercapitalized. Owners in these corporations, usually "S" corporations, figure that if they are going to be taxed on all the profits, they should personally enjoy all the profits. While I truly understand the frustration of paying 39+% taxes on profits that an owner can never touch, doing so is truly necessary for the health of the agency.

Agency owners might consider two strategies (please remember though: I am not a CPA or an attorney and you should discuss all tax strategies with your personal advisors).

First, if the agency is a "C" corporation, consider leaving some profits in it. The effective tax rate on small profits is much less than 35%. By leaving some profits in the corporation that are taxed at a lower rate rather than taking all profits out as compensation, the effective tax rate is less.

Second, if, when you sell, you sell stock rather than assets (stock sales seem to be gaining momentum because so many buyers today are public companies), the money left in the agency gets sold at a 20% tax rate rather than the approximately 39% tax rate that would have been paid had it been taken out as compensation. Also by being properly capitalized, the agency is likely to be more valuable too.

Remember to keep open lines of communication between you and your accountant. Make sure he or she understands your expectations and to do so, you must be certain you know what you want your CPA to do. Do you want tax advice, tax return completion, audits, or business advice? If you want tax advice, make sure you have someone in your agency, a consultant or another CPA possibly, that can help you balance the tax minimization strategy with your other needs. Also if you want tax advice, you might consider hiring a CPA that specializes in tax advice rather than being a generalist. If you need an auditor, consider a CPA that has special audit experience. Also consider having an audit or accountant's review completed periodically so that any errors are corrected early before they grow into very unpleasant surprises.

Extra accounting services do cost more money. However, every agent I know using multiple accountants are finding they are actually saving money and sleeping better too!

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