

APPENDIX A

BEST PRACTICES FOR ACCOUNTING PROCEDURES FOR MICRO-, SMALL-, AND MEDIUM-SIZED BUSINESSES

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I. INTRODUCTION

It is a fact that many micro-, small-, and medium-sized business bookkeeping functions are often performed by business owners, partners, or an assistant because they cannot afford the cost of a fully integrated accounting department. Despite this typically encountered situation, it is important to become familiar with and understand some of the best and basic bookkeeping procedures that apply to these entities.

I will describe them in accordance with the size of the company measured by its volume of annual sales, although please bear in mind that these are approximations and vary from country to country. Part II is predominately applicable to small companies whose annual sales exceed \$300,000 USD per year, and Part III applies to companies whose annual sales are below that amount.

II. MICRO-SIZED BUSINESSES AND THE CASH METHOD

The cash method is simple in that the business's books are kept based on the actual flow of cash in and out of the business. Income is recorded when it is received, and expenses are reported when they are actually paid. The cash method is used by many sole proprietors and businesses with no inventory. From a tax standpoint, it is sometimes advantageous for a new business to use the cash method of accounting. That way, recording income earned but not collected can be put off until the next tax year, while expenses are counted right away.

The cash method may also continue to be appropriate for a small, cash-based business or a small service company.

Under the cash method (which typically is simpler than the accrual method), a taxpayer can defer income recognition until cash is received; conversely, it must wait to deduct the expenses until the amounts are paid. The cash method is undoubtedly the easier method to maintain because the business owner only records when cash is received or cash is paid out. It is intuitive, familiar, and straightforward. Using the accrual method, you will generally have to do more recording and financial housekeeping, although with most accounting software such as QuickBooks, the program does much of the work for you.

III. SMALL COMPANIES AND THEIR NEED TO KEEP THE GENERAL LEDGER CURRENT

A. Accounts, General Ledgers, Statements, and Audits

The general ledger is the basic building block of accounting.¹ And let us not forget that accounting starts with good bookkeeping or with the gathering of

¹ Jeremy Bradley, *Best Practices for Accounting Office Procedures*, HOUSTON CHRONICLE, <http://smallbusiness.chron.com/> (last visited Feb. 14, 2016). Jeremy Bradley

relevant commercial and financial information on the business's activities by including this information into diverse accounts. Because a business's credit-worthiness and prosperity is tied to the reliability of its accounts, the better organized and reliable a company's bookkeeping is, the more reliable its accounting will be. With reliable accounting comes the ability to prepare financial reports and statements. Thus the general ledger contains accounts for assets, liabilities, owners' equity, revenues, and expenses. Under each of these accounts, you may have subaccounts or individual accounts that reflect the various inflows and outflows of money. Each time a transaction happens—say when you make a sale or pay a bill—you should record it in the general ledger in the correct account and then tally and balance the accounts accordingly. By balancing, I mean to make sure that debits equal credits in statements known as balance sheets and income statements. The general ledger thus becomes a reference document. If it is continually updated, the small businessman will have an idea of how much money he has for investment, hiring new employees, or raising salaries.

At the end of each month, quarter, or more often as the circumstances require, it is a good idea to perform a self-audit. This is sometimes called “closing the books,” and it involves adjusting any entries to the general ledger to account for mistakes or oversights. The self-audit also requires that the business close the accounts that have temporary balances. For instance, if a customer owes for a transaction, it must be accounted for in the accounts. The business can decide which balances to carry over to the next period and use the self-audit to get a snapshot of changes in expenses and revenue.²

B. The Need for an External Auditor

Some small businesses are required by most governments, banks, private lenders or investors, to hire an external auditor to review their books and financial statements. Even if your business is not legally required to do so, employing an external professional accountant and or auditor is a best practice in keeping your business financially sound. An external auditor is an independent entity who reviews the general ledger, checks the account transactions, and corrects any mistakes or oversights in the various accounts. The auditor also checks for any evidence of fraud. Such an audit provides a level of trust in your business to those who deal with it as actual or potential creditors and investors.³

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² *Id.*

³ *Id.*

IV. MICRO COMPANIES AND THE SINGLE-ENTRY SYSTEM

A. The Single-Entry System

Micro companies most commonly operate “on the fly,” i.e., transaction by transaction, often in market stalls or in ambulatory facilities without access to the traditional book keeping systems described in Section II. This is why it is necessary to inquire into what is or are the best functional equivalents of those systems in the micro-world.

A single-entry system may consist only of transactions posted in a simple notebook, daybook, or a daily journal. Some micro-businesses already rely on their checkbooks to keep track of their check disbursements as a journal or register, and as daily/weekly/monthly summaries of cash receipts. At the same time, even developing nations as poor as, say Honduras, people are relying more and more on cell phones to transact business and to keep “to do” or “have done” reminders. Coupled with existing software, these cell phone records could become the functional equivalent of rudimentary accounts and ledgers.

It should be kept in mind, however, that a single-entry system of record keeping does not include equal debits and credits to the balance sheet and income statement accounts. Thus, it is not a self-balancing system of accounting. Mathematical errors in the account totals are thus common. Reconciliation of the books and records to the tax returns is an important audit step. For an example of a single entry system of bookkeeping, refer to Model A in Appendix A.

B. A Transitional Book Keeping System

Micro companies that are transitioning from an ambulatory form of business to business premises would be well advised to keep in mind that basic business records could be gathered by using the following procedures. Also software is now available, such as QuickBooks/Online/Mobile Applications. Such software can help a small business owner keep a set of books from their smart phone, laptop, or computer for a modest small monthly amount.

The system described hereafter uses the above-illustrated single entry bookkeeping, not the double-entry bookkeeping that is taught to accountants:

- (1) Divide a sheet of paper into columns, use graph paper or a columnar pad.
- (2) Label each page with the current month record income in one column and expenses in several different columns.
- (3) At the end of each month total the Income and Expense columns and carry totals to a summary sheet.
- (4) The above record keeping can be done quite simply on columnar paper or in a spreadsheet (Excel, etc.). This summary spreadsheet monitors the business performance each month.

A quick glance will reveal major sources of income or expenses, the timing of income or expenses, and also break out expenses into categories for additional analysis. This kind of system is used to assist owners of small businesses to keep simple basic bookkeeping and accounting records, improve their cash flows, and to understand the significance of how records can help a business grow.

C. Simple Accounting System

A simple accounting system is based on actual cash flows. In this kind of accounting system, income is recorded when received, and expenses are recorded when they are paid. This data may be entered on a single entry basis. Typically, sole proprietors, businesses with little to no inventory, and service companies will use a simple accounting system. A few benefits of this type of system are that it is simpler than the accrual system and it allows for deferral of income and for acceleration of expenses.


D. Financial Measurements

Your business will be judged by classic financial measures:

- (1) Balance Sheet—Tells how much the business is worth.
- (2) Income Statement—Tells if your business is profitable.
- (3) Cash Flow Statement—Predicts cash balances into the future and explains the sources and its uses.

V. FIGURES AND CHARTS

A. Model A: Bookkeeping Systems



Example Single Entry Bookkeeping System

Date	Description	Ref	Income	Expense	Balance	
1-Apr	Balance b/f				200.00	R
4-Apr	Folders and pens	PE1		15.00	185.00	R
15-Apr	Sale : Ms E Inkson	SI1	54.00		239.00	R
18-Apr	Sale : Mr R U Redy	SI2	30.00		269.00	R
19-Apr	Drawings	D1		10.00	259.00	R
21-Apr	Envelopes and stamps	PE2		20.00	239.00	R
24-Apr	Web host fees	PE3		40.00	199.00	R
27-Apr	Chair and desk: Ch 001	PE4		125.00	74.00	R
29-Apr	Sale : Mr J Mighty	SI3	30.00		104.00	R
30-Apr	Bank Fees	PE4		2.50	101.50	R
30-Apr	Sale : Ms T Real	SI4	54.00		155.50	R
	Balance c/f				155.50	
	Cash Book Balance	155.50				
	Add: Unpresented cheque	125.00				
	Subtotal	280.50				
	Less: Deposit not yet shown	54.00				
30-Apr	Bank Statement Balance	\$226.50				

PE = Purchase Expense
 SI = Sales Invoice
 D = Drawings

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B. Model B: Financial Reports Models**1. Balance Sheet**

**UNIVERSAL DISTRIBUTORS, INC.
BALANCE SHEET
FEBRUARY 28, 2015**

ASSETS**CURRENT ASSETS:**

Cash	\$1,525
Accounts receivable	61,455
Inventories	49,323
Supplies	<u>429</u>

TOTAL CURRENT ASSETS 112,732

PROPERTY AND EQUIPMENT (NET) 9,798

SECURITY DEPOSITS 750

\$ 123,280

LIABILITIES AND STOCKHOLDERS' EQUITY**CURRENT LIABILITIES:**

Note payable to bank	\$ 15,000
Accounts payable	21,225
Accrued expenses	1,200

TOTAL CURRENT LIABILITIES 37,425

STOCKHOLDERS' EQUITY:

Common stock	1,000
Additional paid-in capital	5,000
Retained earnings	<u>79,855</u>

TOTAL STOCKHOLDERS' EQUITY 85,855

\$123,280

C. Income Statement

**UNIVERSAL DISTRIBUTORS, INC.
STATEMENT OF OPERATIONS AND RETAINED EARNINGS
YEAR ENDED FEBRUARY 28, 2015**

NET SALES	\$797,260	100.00%
COST OF SALES	678,225	<u>85.07%</u>
GROSS PROFIT	119,035	14.93%
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	43,429	<u>5.45%</u>
INCOME FROM OPERATIONS	75,606	9.48%
OTHER INCOME (EXPENSES):		
Miscellaneous	127	0.02%
Interest expense	(1,800)	<u>-0.23%</u>
	<u>(1,673)</u>	-0.21%
NET INCOME	73,933	9.27%
RETAINED EARNINGS AT BEGINNING OF YEAR	27,522	
DISTRIBUTIONS	(-21,600)	
EARNINGS AT END OF YEAR	<u><u>\$79,855</u></u>	

D. How to Keep Basic Records

Month of: January			Income	Advertising	Office	Postage	Meals	Mileage
Date	Check Number	Description						
1/09/200X	Debit card	Website fee		\$ 20.00				
1/10/200X		Income from Client A	\$ 250.00					
1/11/200X	203	Ink			\$12.00			
1/15/200X	204	Brochures		\$ 32.00				
1/15/200X	cash	Lunch with Client B					\$ 8.50	
		Mileage to lunch meeting						12
1/30/200X	205	Stamps				\$ 55.00		
1/30/200X		Mileage to post office						6
Totals			\$ 250.00	\$ 32.00	\$12.00	\$ 55.00	\$ 8.50	18

E. Cash Flow**UNIVERSAL DISTRIBUTORS, INC.**STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED FEBRUARY 28, 2015

CASH FLOWS FROM OPERATING ACTIVITIES:	
Change in net assets	\$ (36,972)
Adjustments to reconcile change in net assets to net cash (used in) provided by operating activities:	
Depreciation	277
Changes in operating assets and liabilities:	
Cash	(1,690)
Accounts receivable	22,544
Inventories	17,225
Accounts payable and accrued expenses	<u>1,176</u>
NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES	<u>2,560</u>
CASH FLOWS FROM INVESTING ACTIVITIES	
Purchases of furniture and equipment	<u>(4,250)</u>
NET (DECREASE) INCREASE IN CASH	(1,690)
CASH, BEGINNING OF YEAR	<u>3,215</u>
CASH, END OF YEAR	<u><u>\$ 1,525</u></u>



SECOND PACIFIC-RIM COLLOQUIUM PARTICIPANTS

