TOP ACCOUNTING ISSUES
FOR
SMALL BUSINESSES

As professional services providers, you understand that your small business clients face a myriad of issues on a daily basis. But, many times, the most pressing issues are centered on finances and the accounting function within the company.

Today, we will take some time to briefly discuss the Top Accounting issues that we see among our small business clients. Some of these may be familiar and a few may be new to you, but hopefully this list will provide you with a few “thinking” points when you work with your small business client.

Let’s count them down:

#6 – Selecting the wrong business formation

This is an issue that occurs in the first days of any small business. When starting a company, the management group must select a formation; either sole proprietor, LLC, LLP, S-Corp, or C-Corp. Many times the selection is based on the legal protection provided by each category, but management ignores the accounting consequences of the choice.

#5 – Lack of a sound accounting system

This may seem elementary, but many times businesses do not develop and implement an accounting system that fits the needs of the organization. We define an accounting system as the processes that are used to properly and accurately record fiscal transactions.

Accounting systems are not “one size fits all”; the small business must develop accounting processes that fit the needs of the organization. The goal of management is to create an accounting system, either computerized or manual, that is straight-forward and provides the company the ability to review its financial status at a moment’s notice.

A good accounting system provides management with the ability to generate reports used in the decision making process. It also allows management to review critical fiscal information such as revenues, expenses, accounts receivable, and accounts payable in a timely, efficient manner.

Even though manual systems can be accurate, they are not very efficient, so moving to a computerized accounting process is a smart move. Some of the most popular computerized accounting packages are QuickBooks, Peachtree, Solomon, and Averiware. Each of these software packages are great, but research any software before purchase to ensure it fits your needs.
#4 – Lack of qualified accountants on staff

As accountants we believe the fiscal function is the most important area in any business entity, but, far too often it is the department that lacks qualified personal. When you build an accounting staff, you must employ professionals that have the skills and knowledge needed to properly record the company’s financial transactions.

Everyone believes accounting is all about math and adding numbers, but more important than calculations is the knowledge and understanding of how transactions are recorded. Most people can use a calculator, but in accounting, the primary question is “what are the debits and credits of this transaction?” And if your staff doesn’t understand the “debits and credits” you set yourself up for failure.

Accounting is not universal across all industries. Conceptually, it may be similar, but the manner in which a transaction is recorded in a retail company may be completely different than the manner in which it is tracked in a construction company. So, a thorough understanding of the accounting policies for the industry in which you operate is more important than being good at math.

So, it is critical that your client’s accounting staff has industry experience in addition to strong math skills.

NOTE: A TAX PREPARED IS NOT CONCERNED WITH THE EVERYDAY RECORDING OF THE COMPANY’S TRANSACTIONS.

#3 – Understanding cash vs. accrual accounting

There are two primary basis of accounting; cash and accrual. Under the cash basis of accounting, revenue and expenses are recognized when cash comes into the business and when cash leaves the organization. The accrual basis of accounting recognizes revenue when earned and expenses when incurred, regardless if actual cash has been received or disbursed.

Without getting too deep into the subject, a company should utilize the accrual basis when recording financial transactions. The accrual basis of accounting will allow the company to track items that are not recorded under the cash basis such as; accounts receivable, accounts payable, and accrued expenses. Another reason that the accrual basis should be employed is because this principle is considered to be a generally accepted (GAAP), and third-party users of your financial statements, such as banks, investors, and other creditors, will expect your fiscal reports to be prepared on the accrual basis.

The cash basis of accounting is traditionally utilized for the completion of a company’s tax returns. It makes sense for many small businesses to utilize the cash basis when reporting income and expenses to the Federal, state, and local taxation agencies as you would only want to pay tax on revenue that was actually received as the cash would be on-hand to pay any tax obligations. Under the accrual basis, you would be paying tax on revenue that may have not been collected, therefore, creating the possibility of a cash shortfall.
#2 – Maintaining proper financial records

Many times small businesses don’t understand the importance of maintaining proper documentation that substantiates the financial transactions recorded on the company’s accounting books and records. Proper recordkeeping is essential for many reasons, but most importantly, substantive documents are needed for financial statement audit and tax preparation purposes.

If your client requires an annual financial statement audit, substantive documents are needed to complete the examination process. If substantive documents are not available, the organization cannot obtain audited financial statements from an independent, CPA firm. In addition, the CPA firm may issue a qualified or adverse opinion of the financial statements of the company.

In regards to tax returns, the preparer uses documents such as invoices, cancel checks, and bank statements to complete the tax reporting process. In addition, the IRS has 7 years to audit a filed tax return, so maintaining proper documentation will be essential in gaining a successful outcome in the event of a tax audit.

We advise our clients to follow the document maintenance guidelines prescribed by the IRS. These guidelines can be found at [www.irs.gov](http://www.irs.gov).

#1 – Proper preparation and filing of tax returns and reports

Everyone knows that taxes are one of the certainties in our society, but not everyone is in tune with the proper preparation and filing requirements for these important reports. Tax return preparation and filing is a huge responsibility for a small businesses and small-business owners. Tax returns are the culmination of the year’s fiscal transactions. The tax return is the document where the company reports information such as revenue, expenses, assets, liabilities, ownership characteristics, and certain changes in operations.

Unfortunately, small businesses sometime miss the mark when it comes to tax reporting. Even if you hire an outside preparer, the ultimate responsibility for the return stays with the taxpayer. In addition, a tax preparer understands where items are reported on a return, but may not understand how those transactions are recorded in your general ledger (the document that records all of the company’s transactions); therefore, if issues arise with the fiscal reports generated by your accounting system, they will not be able to provide assistance.

When it comes to taxes, several issues arise. The primary stems from the fact that management doesn’t understand that information on a tax return is carried forward from year to year; therefore, undocumented changes to prior period balances is the most common hurdle in accurate tax reporting. There is never a problem with going back and correcting an error, but ensure that you document the change for the tax return.

The next issues arise from self-preparation. This goes hand in hand with our #4 discussed above. Tax preparation is sometimes complicated, so if you are not properly qualified, hire a professional to provide the appropriate guidance and service.
Finally, if your tax return shows a tax liability, and your client is not in a position to pay, file the return anyway! Too many times, when small businesses cannot pay their tax bill management decides not to file the return until they have the funds to fulfill their obligation. This is a bad idea, as tax penalties for late filing are calculated based on tax liabilities. You may owe interest on late tax payments, but you won’t be hit with an enormous late filing fee or failure to file assessment.

**Other Accounting Issues**

- Budgeting
- Pricing
- Cash Flow Projections
- Understanding Financial Statements

Thank you for this opportunity to speak with you today:

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