

Bookkeeping Tips

Professional Readings for Bookkeepers

To make sure our members keep up with many publications they may not have time to read, we give them “Professional Readings” in *The General Ledger* (www.aipb.org/general_ledger.html), the free monthly technical briefing for members. The “Readings” are selected items from a wide range of accounting, tax and business publications specifically of interest to professional bookkeepers:

Here's just a sampling of Professional Readings from prior issues of *The General Ledger*:

* **Home-business writeoffs.** The IRS uses 9 factors to distinguish a business from a hobby. [Treasury Regs §1.183-2] If the business truly is a business and the portion of the home used for business qualifies as a home office, the IRS allows certain expense deductions. To qualify as a deduction, the expense must be *ordinary* (normal, customary or usual); *necessary* (appropriate or helpful for the particular business, such as property insurance for a home office), and *reasonable*—e.g., family members' salaries must be reasonable for the level of work that they do for the business.

The IRS disallows:

- personal residence operations costs;
- salaries paid to children for answering phones, washing cars and related tasks;
- education deductions from wrongfully paid salaries;
- excessive car and truck expenses for vehicles driven for business and personal use;
- personal furniture, home entertainment equipment, children's toys, etc.;
- personal travel and entertainment whose rationale is that everyone is a potential client.

The IRS accepts:

- pharmaceuticals and most medical expenses;
- state and local income tax expenses;
- proportional home mortgage interest expense;
- proportional property tax expense;
- charitable contributions; and
- some investment expenses.

Always take as many lawful deductions as you can, but resist quick and easy schemes to cut income—they can cost you more in interest and penalties than they are worth.

Source: Leonard G. Weld and Kaye F. McClung, “Home Based Business Deductions Are Not Always Legal.” *The CPA Journal*. The New York State Society of CPAs, 530 Fifth Avenue, New York, NY 10036-5101.

(continued)

*** To improve company cash flows:**

1. Project ahead at least 12 months. Know cash shortages occur and have a cash reserve.
2. Have best- and worst-case scenarios. Create appropriate responses to both.
3. Watch spending. Focus on *value* when spending; avoid lavish items.
4. Keep inventory lean. Carry only what will sell in the near future.
5. Don't hire until mandatory. Try to get more from staff or outsource.
6. Lease instead of buy. This reduces outflows on equipment (copiers, etc.) in the short run.
7. Recommend justifying owner salary. Owners should limit their salary to the amount that can be justified by revenues. (Have your assistant make this recommendation.)
8. Give incentives for early payment, such as offering cash discounts or charging late fees.
9. Minimize waste. Re-use anything you can: file folders, computer discs, etc.

Source: "Successful Cash Flow Management," *All Business –Champions of Small Business*, AllBusiness.com.

*** 412(i) retirement plans.** Small firms uneasy about defined benefit plans should consider a 412(i). It may offer the highest tax deductions, largest employer contributions (a plus for owner-employees who want to build up their pension benefits relatively quickly) and highest retirement benefits among qualified plans, and it protects the owner's family if the owner dies before retirement.

A 412(i) has defined benefits, covers owners and employees and must be funded by annuities or a combination of annuities and life insurance. It should be considered by owners who:

1. are 45 years old or older;
2. own a small company or practice with a maximum of 5 employees;
3. have good cash flows; and
4. pay high taxes and want a significant deduction.

Key advantage: The insurer guarantees the defined benefits (use a financially sound insurer). If premiums are paid in a timely way, pensions are not susceptible to market fluctuations (a common problem for defined contribution plans). Contact a pension consultant for details.

Source: Amy C. Bryan, "Keys to 412(i) Plans: Focus on Target Market and Plan Details," *National Underwriter Life and Health*, National Underwriter Company, 5081 Olympic Boulevard, Erlanger, KY 41018.

*** Electronic A/P and A/R are here.** A recent Institute of Management and Administration survey revealed that:

- Over 25% of companies surveyed currently use electronic invoicing, another 35% plan to begin electronic invoicing within one year.
- Among the largest companies, 65%-85% will have e-invoicing within a year; among the smallest, 30% (a significant number for generally less sophisticated operations).
- All major industries reflect the above percentages.
- Over 87% of governmental agencies will process invoices electronically within one year.
- Most invoices are still paid by check, but 8% of those surveyed use the ACH network, a reliable nationwide batch-oriented EFT system.
- 40+% of firms make some payments electronically; 32% plan to in the near future.

To avoid losing float, 35% of electronic payers (60% of large companies) negotiate paying slightly later, near the date their bank balances would be affected if they were paying by check.

Source: "Over Half of AP Depts. Will Use e-Invoicing and e-Payments by End of '05." IOMA's Report on Managing Accounts Payable.

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* **Reducing payment errors.** Although only a very small percentage of A/P transactions are handled incorrectly, the average error is around \$1,000.

Most common errors:

- paying the wrong vendor (because of similar names or numbers);
- paying a credit invoice (because credits and regular invoices look alike);
- paying overlapping bills twice;
- paying the wrong amount (invoices are confusing);
- not using credits or rebates (A/P doesn't know about them);
- paying for goods or services not provided;
- paying two parties for the same goods or services (both provider and shipper);
- paying extra charges not owed;
- paying for the wrong quantity or at the wrong unit price;
- paying excessive taxes or taxes that do not apply.

To avoid A/P errors:

- review and clean up vendor files;
- number invoices currently not numbered and always look for missing information on invoices (helps avoid duplicate payments);
- integrate or establish good lines of communication between A/P and Purchasing to assure that A/P has good purchase-order information;
- carefully inspect all transactions over a specified dollar amount;
- track problem vendors and examine their invoices carefully; and
- use a payment recovery firm (specialists in finding and recovering erroneous payments).

These steps can eliminate 50% of erroneous payments.

Source: J. D. Casher, "How to Find and Eliminate Erroneous Payments." Recapinc.

* **401(k) plans.** Even a one-person business will find major advantages of the 401(k) over the more usual SEP or SIMPLE IRA as a result of more relaxed rules on maximum contributions included in the 2001 Economic Growth and Tax Relief Reconciliation Act. The three major advantages for businesses of this size are as follows:

1. The proprietor or owner/employee of a one-person corporation or LLC who earns less than \$210,000 annually can take a bigger tax deduction than under the other plans.
2. The proprietor or owner/employee can borrow from the plan with certain limits (the other plans treat funds removed from the plan as taxable distributions that may be subject to additional penalties based on the recipient's age);
3. The borrower may use the proceeds to purchase life insurance, which would act as a preretirement survivor benefit.

Funds borrowed from a 401(k) can also be used as a limited source of operating cash. If firms under other plans wish to purchase life insurance, they might have to divert cash from other uses. Life insurance premiums are restricted to 25% of allocable plan contributions.

SEP and SIMPLE IRA funds can be rolled over into a combination 401(k)/ profit-sharing plan. Such combo plans will soon become the plan of choice for one-person operations. Ask your advisor to analyze potential savings.

Source: G. B. Kozol, "Advantages of 401(k) Profit-Sharing Plans." *The CPA Journal*. The New York State Society of Certified Public Accountants, 3 Park Avenue, New York, NY 10016.

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The American Institute of Professional Bookkeepers (AIPB), is the national association for bookkeepers, currently with 30,000 active members

AIPB was founded in 1987 for the following purposes:

- To recognize bookkeepers as accounting professionals
- To make sure that each member has the latest bookkeeping, accounting and tax information
- To answer members' everyday bookkeeping and accounting questions on the telephone at no charge.
- To provide bookkeepers with low-cost continuing professional education.
- To return the membership fees of any bookkeeper who is dissatisfied with the benefits of membership