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AN ANALYSIS OF PROBLEMS ENCOUNTERED IN RECORDKEEPING  
AND REPORTING FOR SMALL BUSINESSES

A THESIS

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BY

BERNICE CALHOUN

SCHOOL OF BUSINESS ADMINISTRATION

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Dedicated to the four people who have contributed most to the fulfillment of my desire to attain higher educational achievements

Bennie L. Calhoun, Sr.  
Mattie F. Calhoun  
Bennie L. Calhoun, Jr.  
Otha L. Calhoun

and of course to Lois and Annie, whose understanding and concern, during my stay at Atlanta University have been "above and beyond the call."

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## CHAPTER I

### INTRODUCTION

Purpose of the study.--In order for any business to expand and operate efficiently, some form of financial information is necessary to provide management with knowledge as to: what the business is doing and where it is going.

Rarely does the practical businessman have any inclination for bookkeeping. Preoccupied as he is with the multifarious matters of detail in the control of a competitive concern, often superimposed upon active participation in the business in a working capacity, he has little time available for the keeping of accounts and records. It is little wonder that bookkeeping is distasteful to him and that he regards this work as unproductive and burdensome.

The small trader, contractor or manufacturer usually possesses a high degree of skill in his own particular vocation and often enjoys the benefit of years of experience. Of necessity, his interests must be mainly confined within the compass of his own trade and he has neither time nor disposition to study even the elementary principles of bookkeeping. That the keeping of accounts is essential is usually recognized, but this duty is often regarded as one of the penalties of "working for oneself" instead of in the employment of another, in which case it is not necessary to know anything

about bookkeeping.<sup>1</sup>

Usually, at this point it becomes necessary for the small businessman to employ the professional services of a trained accountant or an accounting firm to present management with the information it needs. There are many problems which the accountant will be faced with in performing this task that are not peculiar to large business concerns. It is the purpose of the writer to set forth those problems deemed pertinent which are encountered in recordkeeping and reporting for small businesses.

Significance of the study.--This study is considered significant because it will provide those entering the accounting profession an insight into the particular problems they will be confronted with in dealing with small businesses. It will further acquaint those already in this field an opportunity to evaluate their particular problems in relation to those determined significant by the writer. Lastly, this study will have the effect of providing the small businessman with first hand information as to what problems are encountered in handling his records.

Statement of the problem.--This thesis has been undertaken to determine what, if any, are the particular problems encountered in recordkeeping and reporting for small businesses. Specific emphasis shall be centered around the different

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<sup>1</sup>Frank H. Jones, Bookkeeping For The Small Trader (Lons-  
lon Tower House, 1947), pp. 1-17.

problems that accountants and accounting firms face in handling small business accounts.

Identification of small businesses and accountants.--

This study is designed to include all businesses which qualify according to the definition constructed by the writer.

Small business-any concern engaged in the production of goods or the offering of services for a profit and which does not maintain a full-time accountant in the establishment and also whose management does not possess the necessary financial know-how to prepare and interpret accurately, financial data according to generally accepted accounting principles. Further, for purposes of simplicity, this definition has been limited to companies with sales less than \$1,000,000 per year and total company personnel does not include more than 50 employees at one time.

Those who are responsible for accumulation and presentation of accounting data are known as "accountants." There are however, many different classes of accountants since accounting work must be performed for a wide variety of units of business enterprise.<sup>2</sup>

The persons and firms which were used in determining the projected problems are as followed:

1. Public accountants-an organized business unit or individual who provides accounting services to others, which include auditing, systems installation,

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<sup>2</sup>Edison E. Easton and Byron L. Newton, Accounting and Analysis of Financial Data (New York: McGraw-Hill Book Company, 1958), p. 119.



preparation of tax returns, general accounting work, and consulting on all phases of accounting.<sup>3</sup>

2. Certified public accountants-persons holding a license which permits the individual to hold himself out as competent to render professional accounting services to the public generally.<sup>4</sup>

Information has also been obtained from individuals who are not registered accountants but who hold themselves out as capable of compiling the financial information necessary for the small businessmen.

Definition of relevant terms and statement of assumptions.--In order to fully comprehend the particular problems which will be set forth in the analysis, some understanding of the concepts to be used must be noted. For this reason, the following terms are defined.

"Financial statements"-descriptive, monetary measurements of financial conditions and operating results for a unit of enterprise. The phrase financial report will be used with the same connotation as a financial statement in this study. This term will be used to include:

1. Statement of financial condition
2. Statement of changes in earned equity
3. Statement of income and expense

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<sup>3</sup> Ibid.

<sup>4</sup> John L. Carey, The Accounting Profession: Where it is Headed? (New York: American Institute of CPAs, 1962), p.27.

Assets-wealth provided by owners and creditors, plus such wealth as is accumulated through operations and retained for use in the business.

Liabilities-debts due to outsiders, normally measured by the dollar amounts that must be paid out in order to liquidate the obligations.

Owner's Equity-expresses the financial interest of the owner in the assets of the business.

Income-a monetary measurement of valuation received in exchange for goods sold and/ or services rendered.

Expenses-expired costs of items or services that have been consumed or used.

Cost of Goods Sold-represents the net cost of the merchandise that has been sold to customers during the period of time showed in the financial statement.<sup>5</sup>

It is assumed in handling the accounts for small businesses that every effort is made by the accountant to treat the records in a manner consistent with generally accepted accounting principles. Problems resulting in this study will be those that represent deviations from those principles.

The following are four basic concepts which will be used throughout the analysis in evaluating the businesses employed in the study.

The Entity Concept-considers a business as a unit separate and apart from its owner or owners. Consequently, in order to measure accurately the financial condition and acti-

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<sup>5</sup>Easton, op.cit., pp. 3-16.

vities of a business, the personal transactions of the owner or owners are not included in the business records or reports.

The Going-Concern Concept-is the assumption that a business will continue for an extended period of time, perhaps indefinitely.

Original Cost-usually the total amount paid and/or to be paid for a service, right, or tangible item. The cost evaluation or book value of an asset is the original cost less any portion of original cost that has been charged as an expense.

The Doctrine of Consistency-the generally accepted belief that the methods of valuation and other accounting principles adopted by a business should be altered or changed as infrequently as possible.<sup>6</sup>

Review of related literature.--An extensive search for specific literature to support this thesis produced no information written with primary emphasis on this subject. There were, however, several books which made general reference to pitfalls in the accounting practices of small businesses. These books will provide a background for better understanding the types of problems which the writer intends to cover. Specific excerpts from these books will be presented throughout the thesis.

Related information has also been obtained from pamphlets published by the Small Business Administration. These pamphlets give general reference to the different problems

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<sup>6</sup>Easton, op.cit., p. 167.

facing small business concerns. References to these problems should be viewed in terms of what the accountant may expect as far as existing internal conditions in the business are concerned.

Pertinent information by a competent authority in the form of a speech provided further insight into the problems discussed in this thesis.

Methods used to analyze the Problems.--The methods that were used to collect, organize and evaluate the problems treated in this study were as followed:

1. Interviews with accounts and representatives of accounting firms. The selection of certain of the accountants was arbitrary, while definite recommendations by faculty advisors produced the remaining persons contacted.
2. Observation of raw data and tools used in the book-keeping process by the accountants.
3. Personal experience obtained by the writer while working for a public accountant.
4. Employing books and articles from the library.
5. Analyzing materials received from government agencies and private industry regarding small businesses.

Limitations of the study.--It should be noted that while a wide array of different accountants were interviewed for information, the total number contacted was very small. Therefore, it can not be assumed that an adequate represen-

tation of all pertinent problems has been thoroughly accomplished.

Anticipated results of the study.--At the outset of this study, it was believed by the writer that there were certain definite problems encountered in the recordkeeping and reporting for all small businesses. These problems were believed to be of such magnitude that they deserved extensive consideration to determine their scope and effect on normal business operations. Further, it was projected by the writer that these problems were centered around and directly relating to the lack of financial knowledge in management. The general hypothesis, therefore, of this thesis is that all of the problems encountered resulted from some human element lacking in management.

## CHAPTER II

### IDENTIFICATION OF PROBLEMS ENCOUNTERED IN THE RESEARCH

Basis for classification.--Preliminary to the acceptance of the problems to be mentioned later in this chapter, some confirmation as to their validity and source must be proclaimed.

All of the problems presented have been identified as being relevant by atleast two of the accountants interviewed, or else they are listed as being noteworthy in some acceptable written source consulted. A further basis which determined the listing of a problem was the extent to which it affected the accountant's function in the businesses. Minute appearances of uncontrollable problems were not considered to be of significant importance to warrant their presence in this study. Only those problems which the writer considered to be of a nature that was detrimental or created an unfavorable result in the small businesses are analyzed.

Separation of problems into categories.--The topics under which all of the problems encountered in the research have been grouped are as follows:

1. Control mechanism or internal control.
2. Lack of accounting backgrounds in the small businesses.

3. Understanding of different uses of accounting in the small businesses.
4. Effective communication.
5. Range of service fees.
6. Qualifications of persons providing accountant with records.
7. Personality conflicts.
8. Cost analysis.
9. Inventory valuation.
10. Budget Planning.
11. Excessive reliance on accountant's opinion in making decisions.

Identification of the range of the problems.--In order to get a broad view as to how many of the problems were present in all of the businesses contacted, this simple chart has been constructed (see table 1).

In looking at the first problem in the table, the need for some type of control mechanism was found in all of the accounting offices. However, this was considered to be of major importance in only 75% of the businesses. The other 25% did not view the need for a control mechanism as important because the bulk of the bookkeeping functions were completed in the small businesses before they began analyzing the records.

A lack of an adequate financial background in the small businesses which served to restrict the recordkeeping process was considered to be important in all of the businesses.

TABLE I  
SCOPE OF PROBLEMS ENCOUNTERED  
IN SELECTED RESEARCH

Problem Topics	Appearance in businesses	Major Problem	
		Yes	No
Control Mechanism	100%	75%	25%
Lacking Accounting Background	100%	75%	25%
Understanding Uses of Accounting data	100%	100%	
Effective Communica- tion	100%	100%	
Range of Service Fees	75%	75%	
Qualifications of persons providing records	75%	75%	
Personality Conflicts	100%		100%
Cost Analysis	100%	75%	25%
Inventory Valuation	50%		50%
Budget Planning	75%	25%	50%
Excessive reliance on Accountant's opinion	75%	25%	50%



The reason that it was not considered of major importance in all of the firms was the same as in the previous problem. The bookkeeping function was performed by outside help before the accountant started analyzing the data.

The third problem topic, an understanding of the uses the accounting data can serve were seen in all of the businesses. Also, this was considered to be a significantly important problem in all of the businesses. The only uses that most of the small businesses made of their accounting data was either for income tax purposes or either in compliance of a lending institution's request for information to justify a loan.

The fourth problem area, communication, was one of the most significant problems in the research. All of the accounting firms encountered this problem. Also, all of the firms considered this to be a major problem. The reason that communication is such a problem is because the small businesses do not or refuse to understand the language in which the accountants talk. One accountant indicated that even though direct advice was given to the small businessman concerning how a certain matter should be handled or a change that was deemed necessary, he chose to ignore the advice.<sup>7</sup>

Another problem dealing with the price range which the accountants handling small accounts were forced to limit their fees were considered to be important in only 50% of the busi-

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<sup>7</sup>Interview with Mrs. Willieboyd McNeil Saddler, Blayton C.P.A. Office, June 27, 1967.

nesses. These accounting firms were usually staffed by only one C.P.A. who was limited in the volume of work which he could perform. The lack of qualified personnel prevented the accountant from carrying more accounts. Also, it was considered necessary to limit the fees charged to a level which the businesses could afford.

The other 50% of the businesses had set rates which initially determined whether the small businesses could afford the services. As in the case of one large, nationally known accounting firm, the rates were set so that only a certain caliber of small businesses could, or would even consider using their services.<sup>8</sup> This tended to insure the ability of the small businesses to pay these fees regardless of their sales level.

The sixth problem dealing with the qualifications of the persons responsible for supplying the records to the accounting firms were of importance in 75% of the firms interviewed. Of this 75%, only 50% indicated that this was a major problem. The reason for this was that the persons providing the accounting data did not know what to supply or else, as in the case of the owner providing the information, he chose to leave out that which he considered to be of no use to the accountant. In cases where the accounting information was mailed to the accountant, it was determined to be prudent for the small businessman to include all of his personal transactions. The justification for this action was that the

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<sup>8</sup>Interview with Mr. Al Braxton, Arthur Anderson & Company, June 20, 1967.

accountant would know what was deductible on the small business at the end of the year for income tax purposes.<sup>9</sup>

The next problem area deals with the ability of the small businessman to do effective cost analysis. In all of the firms contacted, it was reported that they handled accounts where the small businessman did not understand anything about cost analysis. This was considered to be a major problem in 75% of the cases. In the other 25% it was not termed relevant for the businessman to have an understanding of cost analysis since there was an outside person coming into the business to perform bookkeeping functions in the presence of the owners.<sup>10</sup> Further any matters which required cost analysis were later handled by the accounting firm after an outside bookkeeper had compiled the data.

The eighth topic to be discussed under the problems encountered in recordkeeping and reporting for small businesses deals with personality conflicts. There was unanimous agreement among all of the accountants to the effect that they had on occasion had some personality conflicts with some of their clients. Uniformity was achieved again when all of the accountants agreed that this was not a serious problem. The majority of the firms indicated that when they encountered a client who was difficult to work with, it was recommended that he find another accountant to handle all of his

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<sup>9</sup> Interview with Mr. Curt Doernberg, Mail-Me-Monday Bookkeeping and Tax Service, June 21, 1967.

<sup>10</sup> Interview with Mr. Al Braxton, Arthur Anderson and Company, June 20, 1967.

accounting work.<sup>11</sup> In the case of the large established firm, the representative indicated that if a client could not cooperate with one accountant, there were enough available so that he would have a wide choice from which to locate one whom he could deal with satisfactorily.<sup>12</sup>

The next problem topic deals with inventory valuation. Only 50% of the firms indicated that this type of problem was encountered. All of the 50% did not consider this a major problem. In almost all of the firms, the companies left it to the discretion of the businessman to value their ending inventory. In a few cases the accountants would do personal checks of the businesses stock of goods on hand.

The next problem topic to be discussed is concerned with the ability of the small businesses to prepare and follow consistently some type of budget. Only 75% of the accountants faced this predicament. However, all of these accountants indicated that this was a major problem to them. In most cases, they indicated that the businessmen operated out of their cash on hand and in the bank. Rarely does the small businessman have any clearly defined ideas as to what he should or should not spend in a given period. Very little emphasis is geared toward maintaining a constant control over cash unless the business runs into serious trouble.

The last topic to be discussed will be the extent to

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<sup>11</sup>Interview with Mr. Willie Richardson, CPA, June 22, 1967.

<sup>12</sup>Interview with Mr. Al Braxton, Arthur Anderson and Company, June 20, 1967.

which the small businesses rely on the accountant to make final decisions as to what they should do. Of the total firms interviewed, 75% indicated that this was a problem worth discussing. The 50% that considered this to be a major problem indicated that they had clients who felt that their opinion on matters was sufficient to justify immediate action. They did not look at the other factors surrounding the decision to determine if their entrepreneur background should be utilized in finding a satisfactory solution to the problems. The other 25% who responded positively to this problem felt that some of their clients had a tendency at times to rely heavily on their opinion. However, this was not a widespread practice but it was serious enough to justify further analysis.

Appearance of problems in other related research.--

The other sources of information relating to the problems encountered in this research were obtained from pamphlets written for the Small Business Administration. One special study conducted by the Bureau of Business and Economic Research, Northeastern University under the Small Business Administration Management Research Grant Program served to greatly strengthen the validity of the problems reported by the author.

A survey of accounting practices in small business establishments in Massachusetts indicates that many small businessmen are not aware of the advantages of a good accounting system. As a consequence, they are not managing their

businesses as well as they could if they utilized more fully the accounting techniques available to them.<sup>13</sup>

Some of the results of this study have been summarized in the following tables. An explanation as to what these results represent will be stated after each table. (see table 2 and 3).

TABLE 2  
PROFITABILITY RATINGS AND ATTITUDES TOWARD  
ACCOUNTING FUNCTION

<u>Response</u>	<u>No.</u>	<u>Highly Profitable</u>	<u>Moderately Profitable</u>	<u>Unprofitable</u>
Absolutely essential to successful operations	48	83	15	2
Contributes substantially to the success of the firm	56	72	26	2
Contributes to the success of the business somewhat but does not consider the cost justified	30	60	37	3
Does not contribute to the successful operation of the business	<u>18</u>	29	53	18
	<u>152</u>			

Each of the respondents interviewed was asked how important he considers accounting to be a factor contributing to the success of the business. One-third replied that they considered sound accounting to be absolutely essential to

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<sup>13</sup>Albert Slavin and Seth Avakian Mrmen, Small Business Accounting In Massachusetts: Practices and Problems (The Bureau of Business and Economic Research, Northeastern University, 1962), P. 7.

successful operation. A slightly larger number (36 per cent) indicated that good accounting practices made an important contribution but were something less than absolutely essential. One-fifth of the respondents feel that good accounting contributes to the success of the business somewhat but generally is not justified by the cost involved. An the remaining 11 per cent felt that accounting makes no contribution to the success of the business.

TABLE 3  
NUMBER OF RESPONSES TO QUESTIONS DEALING WITH  
FUNCTIONS PERFORMED BY ACCOUNTANTS

	<u>Non-Manufacturing Concerns</u>		
	<u>Independent Public Accountant</u>	<u>Company Staff</u>	<u>Other<sup>a</sup></u>
Auditing of records without an opinion or certificate	67	31	9
Preparing tax returns	276	54	22
Preparing financial statements	218	113	20
Keeping the books	46	257	10
Preparing operating ratios, statistics, and analysis	95	121	15
Preparing budgets and forecasts	37	105	7

<sup>a</sup>Other refer Data Processing agencies.

This particular survey indicates that the majority of small businesses use the services of independent accountants mainly for preparing tax returns and financial statements.

An impressively large number of the firms keep their own book. The preparation of budget and statistical data is also done in the businesses.<sup>14</sup>

The foregoing tables have been included in an effort to give some background as to the particular functions which the accountant performs in the small businesses. All of the functions included in the tables fall within the categories which are being discussed in this study.

In addition to the functions listed in the tables, here are some other specific services which the accountant can perform for the small businessman.

1. Reviewing the accounting needs of the small manufacturing plant.
2. Advising as to records and recordkeeping.
3. Assisting management in the interpretation of financial statements.
4. Auditing financial statements.
5. Helping to determine capital requirements.
6. Providing cost accounting systems and procedures.
7. Aiding in the preparation and use of budgets.
8. Providing inventory controls.
9. Assisting in establishing sound credit procedures.
10. Helping to develop sound sales policies.
11. Working with attorneys and other professional consultants to provide sound financial management drafting of contracts, determining adequate insu-

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<sup>14</sup>Ibid., pp. 57-66.



rance coverage, preparing of minutes, and the  
like.<sup>15</sup>

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<sup>15</sup>Robert E. Witschey, Public Accounting Services For Small Manufacturers, Small Business Management Series No. 5 (Washington: Small Business Administration, 1953), p.vi.

## CHAPTER III

### ANALYSIS OF THE PROBLEMS

Causes of the problems.--To set forth one cause as being solely responsible for the presence of all the problems encountered in this and similar research would be almost impossible. However, there was uniform agreement from the accountants in the research that the cause of all of the problems evolved from some human element. Whether this is a direct development in the small businesses or else occurs through association with the accountants, the cause can always be traced to some human element.

The first specific reason why problems are encountered in recordkeeping and reporting for small businesses is due to managerial incompetence and/or inexperience.

Managerial incompetence or inexperience shows up in the lack, or inadequate development, of sound policies and procedures. Here are a dozen common pitfalls:

1. Inadequate records
2. Inaccurate information as to costs
3. Lack of inventory controls
4. Failure to budget expenditures
5. Excessive operating costs
6. Little or no internal control or check
7. Little or no tax planning

8. Faulty purchasing practices
9. Faulty sales policies
10. Insufficient capital
11. Lack of sound and effective credit policies
12. Excessive investment in plant and equipment

An analysis of the above conditions shows that they would be definite causes for the occurrence of problems in recordkeeping for small businesses.<sup>16</sup> These are not the only causes that serve to present the accountant with difficulty.

The Annual Report of the American Institute of Certified Public Accountants contains the following paragraph:<sup>17</sup>

"Small business is generally managed by men whose knowledge and experience are primarily in the area of production, sales, or technical know-how. They frequently lack the benefits of proper records, budgeting, financial forecasting, analysis of costs, and other accounting and financial procedures which are commonplace in progressive, larger companies."

This passage tends to reiterate one of the previous causes mentioned earlier, lack of financial depth in management. This is considered to be one of the most important causes for the problems encountered by the accountant.

Another extensive article in the Journal of Accounting (December, 1958 issue) revealed the following important facts and information under the title of: "Accounting Function for Small Business":<sup>18</sup>

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<sup>16</sup>Ibid., p. 1

<sup>17</sup>Conan Doyle Whiteside, Accounting Systems for the Small and Medium-Sized Business (N.J.: Prentice Hall, Inc., 1961), p. 147

<sup>18</sup>Ibid., p. 13

"There are an estimated 4,300,000 separate entities now engaged conducting business on the American scene. Of these, over 4 million-between 95 and 98 percent-are small as measured by the standards of the Small Business Administration.

The economic welfare of 7 or 8,000,000 present owners, and even more millions of employees will be determined almost entirely by the extent to which small business can survive and prosper in a continuously churning and changing economic system.

From 300,000 to 350,000 businesses discontinue operations annually. Reasons for failure have been tabulated as follows:

- Inadequate records.
- Inaccurate information as to costs
- Insufficient long-term or equity capital
- Faulty purchasing practices
- Faulty sales policies
- Lack of inventory control, etc.

The article then continued with information regarding a group of small manufacturing firms which had declared bankruptcy. Three kinds of management errors showed up repeatedly in a study of the reasons for the bankruptcies:

1. Poor financial planning because of inadequate records or failure to use the records available.
2. Poor sales management including deficient product planning and market analysis.
3. Poor general administration culminating in adding expenses not offset by additional revenues...."

(Quoting again from the article:) "The foregoing studies provide ample evidence that today's executive, if he is to be successful, must rely heavily upon a variety of accounting and statistical data to formulate policy, establish controls and guide the activities for which he is responsible.

In order to have the necessary facts available for analysis by a busy man at the right time, the records must be complete, concise, and ready when needed.

The author then concludes that the majority of small businesses do not have adequate records to provide this kind of data."

This passage further emphasize another grave problem which hampers smooth working conditions for the accountant. The inability of the small businessman to provide complete

records for the accountant to analyze tends to complicate the entire reporting process. There is no substitute for concise and readily available financial data when it is needed for processing by the accountant.

The causes of problems dealing with control mechanisms, or more specifically internal control usually stems from a lack of adequate personnel in the small businesses. When the accountant discovers a recurring shortage in cash receipts or an apparent over payment of cash, the cause usually directs itself toward the handling of these two functions by one person. With a shortage in personnel, one person handling all matters concerning cash may not be as careful as one who had an employee with whom to balance his transactions.

In a speech given by Mr. Roy L. Ward at the University of Georgia, he made the following observation:<sup>19</sup>

"The general accounting records of a business should always be designed with internal control procedures as a vital factor. Virtually all large business organizations have such controls. However, the application of such systems to small business enterprises have faced two problems. One is the difficulty encountered because of the small number of clerical personnel, each of whom must of necessity perform many functions. The other problem is that most principals or owners of closely held organizations do not understand the necessity of the controls, and the benefits they may be derived from them."

Another cause which presents problems in the area of control centers around the owner's refusal to comply with the accountant's suggestions to handle their cash transact-

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<sup>19</sup>Speech given by Mr. Roy L. Ward, Lybrand, Ross Bros & Montgomer, What Constitutes Adequate Records For Small Business, at the University of Georgia, p. 5.

ions in a manner that allows immediate checks for accuracy. In an interview with one of the accountants interviewed, it was learned that this company followed a policy of having all of their clients deposit all cash received and to make major cash disbursements by check.<sup>20</sup> Another accountant indicated that his office recommended that some clients use special journal books or logs on which to record cash receipts.<sup>21</sup> In this way, the accountant could always tell what was received and how much was still due. However, there were clients who preferred to collect their own receivables even though there were sufficient and capable staff members to perform this function. This caused a problem because the accountant had to rely solely on the clients for the amount of cash received.

Effective communication is usually directly related to a lack of financial depth in management which was discussed earlier in this chapter. However, this is not the only cause of problems in communication. The response of one accountant was that, "some clients feel that they need the accountant only for one major purpose, to do yearly tax returns. The preparation of data to be used in securing loans is the second, but not as important reason."<sup>22</sup> Any information or advice which the accountant offers on other matters is often

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<sup>20</sup>Doernberg, loc.cit., June 13, 1967.

<sup>21</sup>Richardson, loc.cit.

<sup>22</sup>Saddler, loc.cit.

ignored. This is a serious problem which can cause the duties of the accountant in the business to be more difficult. For example, one accountant indicated that it was necessary to do an initial reconciliation of one client's checking account before any auditing could be performed in the business.<sup>23</sup> This task delayed the normal functions of the accountant and also resulted in unnecessary cost to the small businessman.

The next problem area deals with the fees which some accountants are forced to charge. The cause behind this particular problem is usually that the fees must be low enough so that it will not justify the employment of a full time accountant in the business. Another reason for problems which arise in this area results when small businesses increase the duties which they have hired an accountant to do previously at a predetermined rate.<sup>24</sup> This action causes the accountant either to re-adjust his fee, which in turn produces negative reactions from the businessman, or else the accountant performs the assignment at an inequable rate. The latter choice would tend to stretch relations between the accountant and the businessman because the accountant would be performing services for which he receives no compensation. Another cause for problems in this category would be when the accountant performs certain incidental tasks

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<sup>23</sup> Saddler, loc.cit.

<sup>24</sup> Richardson, loc.cit.

that are related to his main duty, but does not charge his client. Such might be the case when the accountant prepares the financial reports for the businessman and includes an analysis of the data for which he does not charge a fee.

The causes of problems dealing with the qualifications of persons supplying accounting data are many. According to one C.P.A., it is usually necessary to find a competent bookkeeper to handle the elementary or basic accounting functions.<sup>25</sup> Another accountant indicates that he must, on occasion, instruct the person charged with the responsibility of supplying and compiling information of the differences between a debit and a credit.<sup>26</sup> This action has the effect of delaying the normal functions of the accountant.

If a small businessman neglects to keep or provide proper books of account, it will be a matter of difficulty for even a professional accountant to prepare a satisfactory statement of profit or loss and a Balance Sheet each year. A businessman who is unable to produce these documents is at an obvious disadvantage if he should desire to sell his business or to seek a loan (temporary or otherwise) from a banker or other source.

The lack of qualified help to keep up with and perform the bookkeeping function will also act detrimentally on the efficient operations of the business. Customers may not be charged for all the services rendered or goods sup-

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<sup>25</sup>Richardson, loc.cit.

<sup>26</sup>Braxton, loc.cit.



plied to them, leakages may occur in labor costs or material expenses may not be charged correctly to the business, adjustments for the use of the businessman's own residence, car, etc., may be neglected and many other mistakes and omissions, all of which will have a detrimental effect upon profits. Inadequate bookkeeping, moreover, engenders a loose and unsatisfactory moral attitude on the part of staff employees.<sup>27</sup> All of these facts tend to further illustrate the causes of the problems which the accountant encounters.

The causes of problems dealing with personality conflicts can not be readily determined. However, in this particular problem, the human element is quite visible. The actions of people are hard to diagnose. Therefore, as most of the accountants indicated, when they acquire a client who is difficult to work with, they request that he find another accountant "more suitable to his taste."

In determining the cause of problems dealing with cost analysis, reference is again made to the speech given by Mr. Gray:<sup>28</sup>

"Any mention of record keeping for cost purposes brings from the small business man the cry 'it costs too much.' There is no doubt that cost accounting devices do add additional work to the normal accounting procedures and frequently (but not always) results in additional cost....The lack of perpetual inventory necessitates the costly and time consuming job of taking a physical inventory, if the small businessman wants to find out if he is making or losing money."

In most of the firms interviewed, there was a tendency to have the businessman handle his own inventory valuation.

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<sup>27</sup>Jones, loc.cit.

<sup>28</sup>Ward, loc.cit., p. 8.

Leaving this function entirely to the business owners can result in inaccurate inventory figures. With inaccurate figures, the accountant will prepare inaccurate reports.

The causes of problems dealing with budget planning resulted from a lack on the part of management, usually, to fully understand the need for such planning. According to one accountant, "some small businessmen operate out of their checkbooks."<sup>29</sup> They make no effort to do any systematic planning to determine if they are carrying too much inventory, or over extending credit or else, if their expenses are too high.

The practice of some small businessmen to rely excessively on the accountant's opinion in making decisions can be as detrimental as overlooking their advice or suggestions completely.

One accountant indicated that he had some clients who would accept his advice on a given matter without careful consideration of other extenuation circumstances.<sup>30</sup>

The cause of this problem stems from the belief on the part of some businessmen that the professional status of the accountant makes his word more accurate than his own. The tendency for the businessman to believe the accountant is without error simply because he holds himself out to be a financial expert is a serious problem.

Effects of the problems.--Whenever a person perform-

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<sup>29</sup>Saddler, loc.cit.

<sup>30</sup>Braxton, loc.cit.

ing a professional task encounters difficulty or any type of interference, this will have some affect on how well or how prompt he is able to complete his task. There are no exceptions in the cases of the accountants interviewed in this study.

One major affect which results from the problems that face the accountants is that on occasion they must increase their fees, thus making it more costly for the small businessman. When the services of the accountant increases, some small businessmen believe that they should cut costs. The first cost which they deem necessary is the accountant's fee.<sup>31</sup>

Another affect which the accountant faces is that these problems cut down the efficiency with which he is able to perform his duties. Efficiency is based on how well one can perform. It is greatly influenced by the amount of difficulty that is encountered. In relation to the accountant's function, no amount of personal skill over shadows recurring problems in the small businesses.

On the opposite side of the chart, it appears relevant to mention the feedback which the businessman will get from these problems. First, the result will be slower service to the businessman. Second, due to slower service, profitable utilization of the financial data may be hampered. Also, the businessman may be paying for historical data which serves a limited function.

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<sup>31</sup>Doernberg, loc.cit., June 21, 1967

The third affect which the problems encountered in this research have on the accountant and businessmen is that they tend to limit the accountant's willingness to perform at a professional level. Some accountants take a certain pride in being able to accurately organize and analyze their clients' financial transactions and operations. However, the appearance of certain problems tends to lessen the "zeal" with which they perform their duties. This does not mean that they do not provide the small business man with the services which he requires and pays for. It does, however, mean that the amount of enjoyment or pleasure that the accountant gets from working with his client is lowered.

These are not all of the affects which results from the problems which the accountants encounter. However, they are sufficient to illustrate that some detrimental results evolve from the problems originating in the record-keeping duties for small businessmen.

## CHAPTER IV

### CONCLUSION AND RECOMMENDATIONS

Conclusion.--After interviewing several accountants regarding problems which they encountered in recordkeeping and reporting for small businesses, it has been concluded by the author that a wide array of problems exist. These problems are of varying natures and are clearly recognizable as developing from some human element. These human elements generally are present in the small businesses and serve to interfere with the accountant's normal performance of his duties. This human element can be described as some activity on the part of management which generates an unfavorable working environment for the accountant.

This study has also proved that the problems encountered in the research have an affect on both the accountant and the small businessman. The affect is both detrimental and harmful to normal working relations between the two.

Further, it has been concluded that these problems are not only present in one firm but rather there was almost unanimous agreement in most cases of the existence of these problems. Certain problems received 100% confirmation as being a major deterrent in handling the accounts of small businessmen.

Finally, the author recognized that even though these problems exist, there is a possibility that some can be eliminated by conscientious efforts and co-operations between the accountant and small businessman. Based on this observation, certain recommendations have been made.

Recommendations.--The recommendations which will be set forth in this chapter are not meant to be the only answers to these problems. The author feels that some sort of optimum solution should be the focal point for arriving at workable answers. Therefore, some of the answers may not logically work to correct all of the problems which the accountant encounters. They should, however, reduce the effects which the problems cause, even though the problems may not be completely corrected.

Here then are the recommendations for the different problems encountered in the research:<sup>32</sup>

Control Mechanism.--The solution for this problem was taken from the speech given by Mr. Ward.

"Well planned accounting and bookkeeping records, and their constant supervision is necessary to any effective control system. Of equal importance is the clear segregation of duties and the division of work between the clerical employees, so that no one person has complete control over an entire cycle of work. The smaller the number of accounting and clerical employees required, the more difficult is the segregation of duties and the division of work. Where the small business has a limited number of clerks many of the more formal procedures of an internal control system have to be abandoned. The owner, however, by day-to-day observations can partially substitute for some of these methods...

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<sup>32</sup>Ward, loc.cit.

Under any conditions it must be remembered that the installation of internal control procedures is not enough. They must be followed faithfully if the results are to be satisfactory.

Since the clerical staff is usually limited in size, the outline of an internal control system for a small business should cover the following points:

1. Receipt and Handling of Merchandise:

First, maximum physical protection must be given to insure receipt inside the premises of all merchandise delivered by the carriers and, second, the merchandise received must be recorded on a form of receiving report which will provide the data necessary for the approval and payment of the vendors' invoice and for inventory control.

2. Delivery of Merchandise to Customers:

Pre-numbered sales slips should be written up at the time of the sale which includes all pertinent data of the items sold and the basis of the sale, cash or charge. Any merchandise leaving the premises should be checked against a copy of this sales slip.

3. Collection and Handling of Cash and Customers Checks:

There must be an independent method for determining the amount of cash for which the cashier must account, and deposit in the bank, and that all checks received from customers are credited promptly to the proper customer.

4. Accounts Receivable:

Adequate records should provide:

- a) Proper charges for merchandise sold to a customer and proper credit for payment, merchandise returns, and allowances.
- b) Periodic statements to customers of amounts owed, and periodic reconciliation of accounts receivables schedules with schedules of customers' statements mailed.
- c) Limitations on credit and adequate checks on past due accounts, as well as close scrutiny on bad debts written off.

5. Cash Disbursements For Purchases and Expense Items:

Before payment, all purchase invoices should carry on their face satisfactory data indicating that:

- a) The merchandise has been delivered or the services rendered.
- b) The price and extensions have been checked and the proper account has been charged.

6. Payrolls:

Controls of payroll disbursement must provide adequate proof of time worked, names, rates of pay, doubled checked amounts due and proof of payment.

If the small businessman can be encouraged to adopt the foregoing suggestions recommended, few problems will face the accountant in matters involving internal control and control mechanisms.

Lack of accounting background.--This is one of the most pertinent problems encountered in the research. It also is one where no definite solution can be recommended.

Because the small businessman usually possesses only technical knowledge, his willingness to understand financial matters normally take second priority. For this reason, it is suggested that the accountant try to instill within the businessman a thorough explanation of how his knowledge of financial information can greatly improve his ability to make better decisions. By doing this, the enterperneur will hopefully eliminate the gap between his technical and his financial know-how.

Understanding of different uses of accounting.--This



particular type of problem requires the same solution as the preceding problem. The small businessman will have to be informed by the accountant of the different uses of financial data. His lack of understanding stems from a lack or deficiency in financial depth. When this deficiency is corrected, then the business man will have a better appreciation and understanding of the uses of accounting.

Communication.--This is another major problem which requires delicate handling less the affects of this problem are worstened.

Here are a few recommendations for solving problems dealing with communication:<sup>33</sup>

1. As an accountant, it is part of his responsibility to report weaknesses and suggested corrections of these weaknesses to his client. Talking to the client about such matters is not enough. It is important for the accountants own protection to have written proof and recommendations, for should his recommendations not be followed and a subsequent problem develop, the client is likely to blame him for failing to call the matter to his attention. A copy of the letter is the defense that the accountant needs.
2. Use the telephone as often as possible, and in the

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<sup>33</sup>Fred H. Rohn, How to Make Your Services Worth More: A New Guide To successful Handling of Accounting Clients (New Jersey: Executive Reports Corporation), pp. 98-99.

same way as personal meetings. Make the telephone adjunct to the accounting campaign to keep close to the client and his business affairs.

3. Meet with the small businessman whenever there is something to talk to him about that cannot be effectively disposed of on the telephone. If there is nothing to talk to him about, invent something and meet him anyway occasionally.

Range of service fees.--Matters involving service fees are also an area which requires delicate handling. It does not take much requesting on the part of the accountant to produce comments of "too much" or "that's above my means" from the small businessman.

Here are a few tactful suggestions which the accountant might follow in trying to prevent or solve the fee problem:

1. Have a definite amount which is charged for performing certain duties. Make sure that the client is aware of what services he is getting for the amount he pays.
2. Immediately bring it to the attention of the small businessman when it is learned that a fee must be re-adjusted. Do this in a professional manner and make sure the client knows exactly what the extra amounts are for.
3. Send the client a rate schedule atleast once a year so that he may decide if he wants the ser-

vices available. Do not wait until a service has been completed before advising the owner that a new "rate" for the year is in effect.

4. Last, to further eliminate problems in this area encourage the small businessman to discuss freely any charges which he considers unfair.

Qualifications of persons supplying the records.--

The most obvious solution but not usually attainable, to this problem would be to recommend to the small businessman that he should hire competent persons to perform this task. In most cases the person charged with performing this function has other major duties which are not at all related to recordkeeping.

The solution which is recommended for this problem is for the accountant to encourage the businessman to hire a competent employee to organize the data to be processed by the accountant. If this cannot be achieved, he should be asked to make some effort to have his present help trained or counseled in the procedures of systematically organizing financial data.

Failing to get his client to adopt either one of the above suggestions, the accountant should impress upon him the cost factors that are involved in this matter. An explanation regarding the amount which the businessman could save if his data was organized before the accountant receives it, would serve as an incentive in inducing him to correct this fault.

Personality conflicts.--This is one of the few problems which, unfortunately, the author has no optimum solution.

The only comment which can be made at this point is that small businessmen, like everyone else, are human. Based on this observation, it is realized that they have certain wants and habits which are unexplainable. If it is found that a client is difficult or impossible to work with, the only alternative is to ask him to seek the services of another accountant.

Cost analysis.--The solution for this particular problem is also taken from the speech given by Mr. Ward.

"while it is easy to refute the objections against cost accounting for small business, it is not so easy to make positive suggestions. Each business is different from any other and there are more variances between small businesses than between big ones.<sup>34</sup>

"All that can be done here is to name a few accounting procedures and records that could be introduced without prohibitive cost, for the benefit of small business.<sup>35</sup>

1. Departmentalization: Departmentalization is one of the most important principles of cost accounting. A department could consist of man or one machine. So for allocation purposes, even the smallest business could be departmentalized. This, of course, in turn will tend to improve the system of internal control.
2. Quantity Records: Records devised to determine the per unit cost can be introduced in almost every general accounting system with-

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<sup>34</sup>Ward, loc.cit., citing Journal of Accounting, January, 1950, p. 9.

<sup>35</sup>Ward, loc.cit., pp. 9-10.

out too much trouble. No businessman knows enough what is going on in his business unless he knows the unit cost of each article he sells."

Along with the above suggestions the accountant should inform the small businessman of the importance of using ratios to determine his profitability, liquidity and equity position.

Inventory valuation.--This is one area in which most of the accountants have chosen to ignore. The small businessman is usually left to final valuations as to how much his inventory is worth. As one accountant remarks, "we give our assistance in this area only when the client requests it."<sup>36</sup> While this may not appear to be a serious problem, thorough analysis of this procedure revealed obvious negative results. One such result was that an insufficient knowledge of the different types of inventory valuation methods may cause the businessman to over or understate his inventory. This has a direct affect on the amount of profit computed.

The best solutions which are deemed feasible under this problem are as follows:

1. Review the businessman's inventory taking procedures atleast once a year.
2. Make sure the inventory amount which is quoted is on a lower of market or cost basis.
3. Recommend that the businessman use different personnel in counting his stock. This way, in-

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<sup>36</sup>Doernberg, loc.cit.

consistencies will be more readily detectable.

Budget planning.--The best plans are of no value unless action is taken to translate them into reality. Every person who can influence profits should have authority in his own sphere but should be held strictly accountable for his operations. The budget, constructed so that every supervisor is held accountable for his own operation, is the key to making sure that the plans become realities. Accounting is the means by which management can exert control.<sup>37</sup>

The accountant should make every effort to instill within the businessman the need for preparing and following some type of budget. If this course of action is followed, it reduces the haphazard manner in which the businessman operates.

Excessive reliance on accountant's advice.--Here, it is not believed that this problem can be solved without a conscientious effort on the part of the accountant. Usually, this problem tends to decrease as the businessman becomes more proficient in his skills. He develops a certain degree of confidence after his business operates successfully for a period of time under the guidance of the accountant.

The only recommendation which can be made at this point is to encourage the businessman to make his own decisions based on information provided by the accountant al-

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<sup>37</sup>Ralph F. Lewis, Management Uses of Accounting: Planning and control for Profits (New York: Harper & Brothers, 1961), p. 13.

ong with other pertinent facts at his disposal.

In final conclusion, the author wishes to point out that no research has been done in this study to determine if these are the optimum solutions for the problems encountered in the research. It will be left to the accountants and small businessmen to determine if they really work!

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