

Messiah Books Case Study

A common question presented to the author is “I can’t get the balance sheet to balance” or “M1 and M2 don’t work”. Much of this problem relates to the enrolled agent not understanding the intellectual framework of accounting.

The purpose of this case study is to take the practitioner through a case where the client presents themselves as honest and ethical, but otherwise a disaster with respect to his records.

Meet your potential new client – Messiah Books.

On a quiet day during tax season (March 10), in walks a gentleman. He introduces himself to you as Messiah Books, President of Shady Lawns Lawn Service, LLC Inc. Call me Messy, he says. All my friends do.

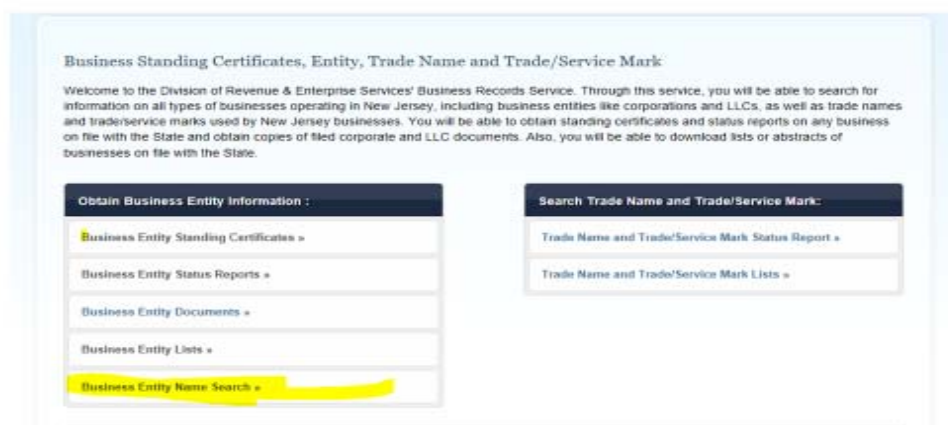
Messiah carries with him an OMINOUS looking BOX.

First thing – What tax return are we preparing?

Clients often confuse their entity type and tax elections. Shady Lawns Lawn Service, LLC Inc, I certainly NOT his entity name. He may be an LLC with an election to be taxed as an S corporation. He could just be an LLC, as many citizens this the C in LLC is Corporation, not Company.

If the client is unable to produce documents related to the formation of organization, the tax professional can look these things up on-line.

A google search for “entity look up (state name) secretary of state” will often bring you to the page you need. In Messy’s case, he is a NJ business. (<https://www.njportal.com/DOR/businessrecords/>).



We then click on 'search registered business':

Business Entity Name Search

For more information on how to search, consult the searching guidelines.

Search Registered Businesses

Business Name

Keyword Search

Entity ID

I entered only "Shady Lawn" in the search box. This is because it is not clear what the true name is. Using less words will return more results, but our answer will likely be in the list. It is possible too

Business Name Search

Search Criteria

Business Name *

Shady Lawn

Use "%" as a wildcard

Search →

Show 10 entries

Business Name
SHADY LAWN LAWN SERVICE LLC

Showing 1 to 1 of 1 entries

Shady Lawn is a cool name – no one else in NJ is using those two words in the name of an activity entity.

We have learned that the business was organized as a NJ LLC in 2014. Messy uses the work "inc" at the end of the company name. **What questions do you want to ask him at this point?**

The Tax Elections

As mentioned earlier in the presentation, since Messy can't provide (and doesn't know if he filed for) an "S" Election, we will collect a fee from him, obtain signed powers of attorney, and then call the IRS and State to determine what elections are in effect and their starting date. Letters will be mailed or faxed to us and then presented to the client. A copy should be kept in your permanent file.

Where do we Start?

Like any client, the practitioner needs client documents to begin. A good start in this case study is:

- Last year's accounting
- This year's accounting
- (Maybe the same program)
- Last year's tax return
- Does it tie in?
- You want a set of double entry accounting for the current year
 - Client provides or
 - Client pays you to do it
 - Don't spend your time trying to do a tax return from incomplete work
- You want to tie into last year's numbers
 - Basis
 - Cash
 - Employee loans
 - All tie into previous years

Schedule L	Balance Sheets per Books	Beginning of tax year		End of tax year	
		(a)	(b)	(c)	(d)
	Assets				
1	Cash				
2 a	Trade notes and accounts receivable				
b	Less allowance for bad debts				
3	Inventories				
4	U.S. government obligations				
5	Tax-exempt securities (see instructions)				
6	Other current assets (attach statement)				
7	Loans to shareholders				
8	Mortgage and real estate loans				
9	Other investments (attach statement)				
10 a	Buildings and other depreciable assets				
b	Less accumulated depreciation				
11 a	Depletable assets				
b	Less accumulated depletion				
12	Land (net of any amortization)				
13 a	Intangible assets (amortizable only)				
b	Less accumulated amortization				
14	Other assets (attach statement)				
15	Total assets				

Current Year Information

When you ask Messiah for his current year accounting, he tells you he has taken care of it. He presents you with the back of junk mail envelope, where he has written:

My Income and Expenses

Deposits	\$ 102,100.00
Pay	\$ 52,000.00
Truck payment	\$ 12,000.00
Gas	\$ 4,000.00
Mowers and trimmers	\$ 5,700.00
Job material	\$ 30,630.00
Utilities	\$ 12,000.00
Rent	\$ 12,000.00
Total of my right offs	\$ 128,330.00
LOSS TO DEDUCT	\$ (26,230.00)

What questions do you want to ask?

- Are all the deposits sales?
- What is included in "pay"?
- Truck payment?
- Is gas an estimate?
- What is 'M&T'?
- Job material is exactly 30% while all other numbers are even

- Do you rent a facility?
 - Utilities & Rent?
 - Did you take any money?
- Where all expenses through the bank?

Answers to your questions

- Bank Deposits
 - Sales \$90,000
 - Cash - \$10,000
 - Sold old equipment \$2,100
- Pay
 - \$22,000 'draws to me' – no taxes
 - \$33,458 payroll (has W2s)
 - \$2,894 payroll taxes
 - \$2250 workers comp paid cash
- Truck and trailer payment is actually \$996.66/month
 - Truck cost \$40,000 + tax + tags
 - $\$40,000 + \$3,200 + \$200 = \$43,400$
 - \$3,400 down on 11/1/2014; borrowed \$40,000 at 12%
- Gas
 - Debit card \$1,960
 - Cash receipts (drivers) \$440
- Bought new mowers and trimmers from dealer
 - 100% no interest financing, card is in his name, no payments until July 1, 2016

Job material charged at nursesey \$30,630. Paid \$27,500 during 2015

Messy's Envelope

ACCOUNT	DEBIT	CREDIT	MEMO
Sales		90,000.00	
Sales		10,000.00	
Gain on Equipment Sale		2,100.00	
Distributions	22,000.00		
Payroll Expenses	33,458.00		
Payroll Tax	2,894.00		
Worker's Compensation Insurance	2,250.00		
Interest Expense	3,205.68		
Auto Expense	1,960.00		
Auto Expense	440.00		
TPP Expense Election	5,700.00		
COGS	27,500.00		
Ask My Accountant	2,692.32		Missing cash ?

The Balance Sheet

- Ending Cash
- Equity?
- Payable to Nursey?
- Why are distributions only \$8200 not \$22000
 - Basis?

No balance sheet from last year

- Opening cash
 - Bank statement
- Closing cash
 - Bank statement
- Balance sheet
 - Doesn't exist
- Depreciation

4562 from prior years

- What about that \$2250
- What about the truck and trailer?
 - Amortization schedule
 - Check that he made the payments
 - Does the ending balance tie to bank (call bank)?
- Cash receipts for driver
 - Paid through payroll
 - Paid through cash?
 - Paid with other check?
- Do we care about the unpaid nursery bill?

Section B - Assets Placed in Service During 2014 Tax Year Using the General Depreciation System						
(a) Classification of property	(b) Month and year placed in service	(c) Basis for depreciation (business/investment use only see instructions)	(d) Recovery period	(e) Convention	(f) Method	(g) Depreciation deduction
19a 3-year property						
b 5-year property		43,400	5	MO	200 DB	2,170
c 7-year property						
d 10-year property						
e 15-year property						
f 20-year property						
g 25-year property			25 yrs.		S/L	
h Residential rental property			27.5 yrs.	MM	S/L	
			27.5 yrs.	MM	S/L	
i Nonresidential real property			39 yrs.	MM	S/L	
				MM	S/L	
Section C - Assets Placed in Service During 2014 Tax Year Using the Alternative Depreciation System						
20a Class life					S/L	
b 12-year			12 yrs.		S/L	
c 40-year			40 yrs.	MM	S/L	
Part IV Summary (See instructions)						
21 Listed property. Enter amount from line 28						21
22 Total. Add amounts from line 12, lines 14 through 17, lines 19 and 20 in column (g), and line 21. Enter here and on the appropriate lines of your return. Partnerships and S corporations - see instructions						22 2,170

End of tax year	
(c)	(d)
	22,491
)	
43,400	
18,662)	24,738
)	
	47,229

AS OF DECEMBER 31, 2013			
	◊ Dec 31, 15	◊ Dec 31, 14	◊ \$ Change
▼ ASSETS			
▼ Current Assets			
▼ Checking/Savings			
Bank	▶ 22,491.42	◀ 20,603.34	1,888.08
Total Checking/Savings	<u>22,491.42</u>	<u>20,603.34</u>	<u>1,888.08</u>
Total Current Assets	22,491.42	20,603.34	1,888.08
▼ Fixed Assets			
Accumulated Depreciation	-18,662.00	-2,170.00	-16,492.00
Truck and Trailer	<u>43,400.00</u>	<u>43,400.00</u>	<u>0.00</u>
Total Fixed Assets	<u>24,738.00</u>	<u>41,230.00</u>	<u>-16,492.00</u>
TOTAL ASSETS	<u><u>47,229.42</u></u>	<u><u>61,833.34</u></u>	<u><u>-14,603.92</u></u>

5,700
2,250
30,551
20,000
(11,272)
()
47,229

Form 1120S (2015)

▼ LIABILITIES & EQUITY			
▼ Liabilities			
▼ Current Liabilities			
▼ Credit Cards			
Due to Lowe's	<u>5,700.00</u>	<u>0.00</u>	<u>5,700.00</u>
Total Credit Cards	5,700.00	0.00	5,700.00
▼ Other Current Liabilities			
Loan from Credit Union	30,551.31	39,305.55	-8,754.24
Loan from Shareholder	<u>2,250.00</u>	<u>0.00</u>	<u>2,250.00</u>
Total Other Current Liabilities	<u>32,801.31</u>	<u>39,305.55</u>	<u>-6,504.24</u>
Total Current Liabilities	<u>38,501.31</u>	<u>39,305.55</u>	<u>-804.24</u>
Total Liabilities	38,501.31	39,305.55	-804.24
▼ Equity			
Capital Stock	20,000.00	20,000.00	0.00
Distributions	-22,000.00	0.00	-22,000.00
Retained Earnings	2,527.79	0.00	2,527.79
Net Income	<u>8,200.32</u>	<u>2,527.79</u>	<u>5,672.53</u>
Total Equity	<u>8,728.11</u>	<u>22,527.79</u>	<u>-13,799.68</u>
TOTAL LIABILITIES & EQUITY	<u>47,229.42</u>	<u>61,833.34</u>	<u>-14,603.92</u>