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American Institute of Certified Public Accountants

CPA MAS

MANAGEMENT ADVISORY SERVICES PRACTICE AIDS

SMALL BUSINESS CONSULTING PRACTICE AID 12

Evaluating and Starting a New Business

AICPA
American Institute of Certified Public Accountants

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SMALL BUSINESS CONSULTING PRACTICE AID **12**

Evaluating and Starting a New Business

AICPA
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Preface

This MAS practice aid is one in a series devoted to the kinds of management advisory services most often provided to a CPA's small business clients. Even though the same services may also be provided to large clients, practitioners' experience indicates that providing advice and assistance to small, closely held businesses often differs from similar engagements with larger clients. Small businesses frequently do not find it cost-effective to have the breadth of financial and accounting expertise present in larger businesses. Hence, the nature and depth of the practitioner's gathering and analysis of the data may differ when providing services to small and large businesses. Most important, the personal plans, finances, and desires of the small business owner may have a significant impact on current and future operations of a small business, and the practitioner must take them into consideration when providing advice and assistance.

MAS Small Business Consulting Practice Aids do not purport to include everything a practitioner needs to know or do to undertake a specific type of service. Furthermore, engagement circumstances differ, and therefore the practitioner's professional judgment may cause him to conclude that an approach described in a particular practice aid is not appropriate.

For members employed in industry and government, MAS Small Business Consulting Practice Aids contain information that may be useful in providing internal advice and assistance to management.

Contents

Scope of This Practice Aid

Throughout our nation's history, creating and managing businesses have been compelling goals for many individuals. For these people starting a business is the fulfillment of the American dream—the realization of personal independence and prosperity. This desire continues unabated and has led to more business start-ups than ever before. Unfortunately, few of these entrepreneurs recognize the risks or are prepared to deal with the management problems associated with starting a new business. As a result, many more new businesses fail than succeed.

This practice aid describes how practitioners can assist clients in evaluating and starting a new business. It also explains how practitioners can draw on their professional training and experience in finance and management to help clients gain the expertise needed to maximize their chances for success. Practitioners can perform both types of assistance as MAS consultations or MAS engagements and may wish to research other business publications for additional information.

Practitioners need to recognize the tax implications of starting a new business. This practice aid discusses many of these considerations. However, because tax laws frequently change, practitioners should be aware of possible alternative approaches.

The Practitioner's Role

In MAS engagements involving business start-up advice and assistance, the practitioner's principal role may include gathering and analyzing facts, including demographic, product, marketing, and resource information; making recommendations about whether to proceed with or abort the business venture; and offering information on alternative organizational forms, such as partnerships or corporations. A practitioner's well-founded recommendation against starting a venture may be crucial, since the client's life savings may be at stake.

If the client does decide to start a business, the practitioner can provide assistance with key activities and tasks involved in the start-up. In any particular engagement the role of the practitioner varies, depending on the client's desires, abilities, experience, and particular circumstances. In some instances it involves coordinating the work of others, such as the client's staff. In other cases the practitioner assumes a more direct role in conducting research and analysis. Regardless of the type of assistance provided, it is extremely important that the client be actively involved in all phases of the engagement. The client makes all decisions about what actions to take; the practitioner does not assume management responsibility in an MAS engagement.

The success of many new businesses depends on the client's business expertise. Therefore, the practitioner needs to be alert to deficiencies in the client's understanding and knowledge, especially with regard to financial management and marketing. After discussing the deficiencies openly and frankly with the client, the practitioner may recommend using educational vehicles or hiring experienced personnel to overcome those weaknesses.

Preliminary Survey

As an optional initial phase of the engagement, the practitioner may conduct a brief fact-finding survey to better understand the client and the engagement request. This preliminary survey includes an analysis of the client's relevant experience and the information the client has gathered on the proposed new business.

The most critical factors to determine at this point are the benefits the client anticipates from the engagement and what the practitioner needs to do to accomplish them. The time devoted to a preliminary survey may be less for an existing client because of the practitioner's familiarity with the client's circumstances.

First, the client and practitioner review, evaluate, and document the client's goals for the new business, and they review the personal as well as financial implications of ownership for the client. A key issue is whether the goals form a solid basis for the proposed undertaking. Second, the practitioner reviews and documents the information the client has gathered. This information includes data on the nature of the product or service, the demand for the product or service, and the opportunities for market penetration. The practitioner later determines the adequacy of this information.

Next, the practitioner assesses the client's financial resources and management capability to determine if these key components of business success are at a satisfactory level for the proposed venture. Finally, the practitioner reaches a conclusion based on the preliminary survey. The practitioner may recommend that the client (1) proceed with the engagement (the formal feasibility study); (2) consider an alternative objective, such as acquiring an existing business; or (3) abandon the project.

Reaching an Engagement Understanding

If the practitioner agrees to proceed with the engagement, he reaches an oral or written understanding[1] with the client that includes the following information:

- Engagement objectives
- Nature of services to be performed
- Engagement scope, including any limitations
- Roles and responsibilities of the practitioner and the client
- The engagement work plan, including major tasks and activities, and, if appropriate, the methods to be used
- Schedule of engagement phases
- Engagement reporting
- Fee arrangements

Conducting the Engagement

Engagements to assist clients in starting new businesses vary considerably, depending on the individual client's business experience and current circumstances. As indicated earlier, in some cases the practitioner's involvement is in the nature of a consultation rather than an MAS engagement.[2] Assuming the client requires an engagement and wants assistance from initial research to actual business start-up, the practitioner might structure an engagement into six phases, such as the following:

1. Data gathering
2. Analysis of information
3. Planning—tax and legal considerations
4. Planning—operational considerations

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1. For information on MAS engagement understandings, see Statement on Standards for Management Advisory Services (SSMAS) No. 2, *MAS Engagements* (New York: AICPA, 1982).

2. For definitions of *consultation* and *engagement,* see SSMAS No. 1, *Definitions and Standards of MAS Practice* (New York: AICPA, 1981).

5. Final report
6. Implementation

The particular engagement structure used here presents information for the practitioner providing assistance to a client starting a new business. It is not intended to establish a formal structure to be used in all such engagements.

Data Gathering

Practitioners are usually more familiar with feasibility studies for clients with established businesses. Such studies are made when a client desires to grow by adding new plants, expanding existing facilities, merging with and acquiring other businesses, and starting new product lines or services. Fact-finding for these studies is facilitated by a substantial amount of existing historical, financial, and operating data. Unfortunately, new-business feasibility studies generally lack historical information other than from industry and government data. Practitioners need to recognize that these engagements require subjective judgments and caution to avoid clients' decisions based on impulse rather than sound criteria. Detailed fact-finding investigations include examining such matters as management capability and goals, location and facilities, the nature of the industry competition, the products or services, marketing, regulation, and risk—factors which, along with other items, are discussed in the paragraphs that follow.

Management Capability

The management ability of the client is critical to the business's success or failure. Education and training can often prevent incorrect decisions due to lack of information or experience. To assess a client's management ability, the practitioner interviews the owner-manager or management team. Information to gather includes (1) general business experience and experience in the industry to be entered, (2) education, (3) employment history, and (4) time available for the business.

Management Goals

The potential for dissatisfaction and disillusionment can be substantial if the new business does not satisfy the goals of the owner-manager. To reduce the chances for this problem, the practitioner ascertains the personal and business goals of each member of the management team. He may specifically request comments on capital growth, return on investment, retirement benefits, succession plans, compensation levels, and other goals, as well as time constraints.

Location

Selecting a site for a new business is often one of the client's most critical decisions. Matters to investigate include local customer demographics, availability of transportation services, pedestrian and vehicular traffic, access to vendor sources, space requirements, zoning regulations, environmental protection requirements, and local ordinances.

Facilities

Selecting proper facilities for a new business at the outset avoids the greater expenses associated with making changes after the business is established. Facilities should be (1) able to accommodate anticipated needs, (2) cost-effective in terms of required repairs and maintenance, (3) purchased at a fair price or leased at a reasonable rate for an appropriate term, and (4) insured for fire, theft, or natural disaster.

Industry Overview

Lack of information on the industry can hamper effective decision making. The client and practitioner need to find out as much as possible about the industry for the proposed new business. Pertinent information includes financial data and industry averages on such matters as product cost and profit margins, selling-price ranges, income statement and balance sheet data, number of units produced and sold, location and volume of producers, and industry trends. The facts can be obtained from industry associations, bankers, user groups, credit rating agencies, government publications, local chambers of commerce, trade associations, Robert Morris Associates, Dun and Bradstreet, and other sources.

Products or Services

The most basic information a practitioner studies relates to the product or service the new business will depend on to generate its revenue. The practitioner needs to understand the nature of the product or service, the elasticity of its demand, technological changes which may affect it, its life cycle and potential for obsolescence, and the sources of domestic and foreign raw materials and components.

Competition

The extent of competition and competitors' policies and actions significantly impact a client's decision to start a new business. For example, excessively strong competition can prevent a new business from securing an adequate market share. The practitioner needs information about competitors' names, locations, estimated annual volumes, market share, and distribution. From this can follow an assessment of their competitive annual sales, percentage of market served, and distribution capability.

Customer Markets

No new business or industry succeeds unless it has customers who desire its products or services. Information on the current and potential users of the product helps determine the markets to target. Research identifies current and potential end-product consumers, manufacturers, wholesalers, and retailers.

If the proposed business is offering a new product or service, it may be appropriate to conduct a consumer opinion survey or pilot distribution program. Mail or telephone surveys are the most common survey methods. Surveys can indicate potential public acceptance of products or services; however, they are not totally accurate predictors. The practitioner considers the benefits, costs, and time required for a survey or pilot distribution. If a market specialist will be engaged for the survey or pilot distribution, his qualifications and experience need to be carefully considered.

Franchised Businesses

Although the failure rate for franchised businesses is lower than for independent operations, there is still significant risk. In helping a client decide whether to purchase a franchise, the practitioner needs to investigate the franchise organization thoroughly. The client and practitioner visit existing franchise holders and evaluate the cost-benefit of the franchise agreement. Franchises need to be evaluated with respect to availability, cost, purchase requirements, financing terms, and commitments to purchase products or supplies from the franchise organization. Among other sources, the *Franchise Opportunity Handbook* published by the U.S. government offers valuable information.

Risk Factors

In the normal course of operations, some businesses are exposed to more risk than others. This risk factor is important in determining feasibility because of today's increasingly litigious environment. Questions to consider include the following:

1. Can the product be produced or the service rendered at a consistent quality?
2. Is there a risk of consumer injury?
3. Are all permits, licenses, and rights obtainable, if required?
4. What business insurance is necessary?
5. Is appropriate insurance available at a reasonable cost?

Analysis of Information

After gathering the detailed information, the practitioner analyzes it by evaluating each category of data and determining if the more complete findings support the establishment of the proposed business. The practitioner re-evaluates initial judgments based on the preliminary survey. If the proposed business is not feasible, the practitioner advises the client prior to the planning and preparation phases of the engagement. To recommend proceeding with the engagement, the practitioner would believe the following:

1. The client has the necessary skills or experience to be successful, the financial resources to initiate and operate the business, and adequate time to develop the business.
2. The concept of the business is logical.
3. The market can be cost-effectively penetrated or created.

Planning—Tax and Legal Considerations

Selecting the Form of Organization

A critical decision to make before starting a small business is selecting the best form of organization. There are three basic forms—sole proprietorship, partnership, and corporation—each with unique tax and legal considerations. Exhibit B-1, a chart, compares the benefits of various organizational forms.

Sole proprietorship. A sole proprietorship is the simplest form of operation. It offers ease of formation and termination, minimal organizational costs, and flexibility of operation. No separate tax entity is created; the owner includes the net business income or loss as part of the personal tax return and is taxed at individual rates.

However, sole proprietorship has several disadvantages: (1) the owner assumes responsibility and liability for the business; (2) the life of the proprietorship is limited to the owner's life; (3) outside financing can be more difficult to obtain; and (4) employees may not be motivated by a potential for ownership. In addition, certain tax-free fringe benefits and income-deferral techniques are not available to a sole proprietorship. Thus, a client generally selects a proprietorship based on ease of business operation as well as on tax considerations.

Partnership. When there is to be more than one owner, a partnership is often appropriate. A written partnership agreement provides each partner with an understanding of the other's duties, responsibilities, and rights.

The partnership is a separate and distinct legal entity generally not subject to income tax. Profits and losses of the partnership are passed through to the partners and are included in their individual tax returns.

A partnership has many of the same business advantages as a sole proprietorship, including ease of formation and flexibility of operation. More important, it enables a business to pool skills and raise equity capital through the joint association of owners. Potential ownership by employees and ease of securing financing from external sources are additional partnership advantages.

As with a sole proprietorship, a partnership does not enjoy income deferral or tax-free fringe benefits as a corporation does. Furthermore, it has the same liability and limited-life problems as a sole proprietorship has.

Corporation. A corporation is a separate legal and taxable entity. It offers limited liability, continuity of existence, simplicity in transferring ownership, centralized management, potential ownership by employees, and ease of capital formation. Corporations are sometimes subject to additional government regulations and supervision, however.

For tax reporting, incorporated businesses may be able to adopt a fiscal year schedule to complement their natural business cycle and tax payment schedule. This planning consideration can also have tax benefits for individual shareholders. On the negative side, one problem peculiar to corporations is the double taxation of distributed corporate earnings and profits.

S-corporation. An S-corporation offers corporate legal status but receives tax treatment more like that of a partnership. Since not all states recognize S-corporation status under their corporate income tax provisions, practitioners should be aware of local provisions that could reduce or offset the potential benefits of federal provisions.

Since business needs often change, the form of organization selected at the outset may not continue to serve the client's best interests. For example, a partnership or S-corporation could provide tax advantages in loss years, but a regular corporation might offer advantages when profits remain in the corporation for expansion. Real estate is also an important consideration when selecting the form of business. It is often kept separate from the operating business so that either can be sold separately. If a corporation sold the real estate as an asset divestiture, it might be difficult to get the proceeds to the stockholders without excessive tax cost.

In summary, the final responsibility for selecting the business form rests with the client, after the practitioner and the client's attorney have fully informed the client of the ramifications of each type of organization.

These ramifications might include liability considerations, continuity of the business, possibility of initial losses, and retirement planning.

Selecting a Bank

Adequate banking arrangements are important to a business, since unsatisfactory situations can needlessly complicate financial operations. In helping the client select a bank, the practitioner weighs the following for each bank under consideration:

- Financial knowledge of the potential industry
- Access to a broad range of financial resources
- Full-service capability
- Degree of personal service
- Overall understanding of the client's needs
- Authority and ability of personnel to make decisions
- Lending reputation
- Familiarity with the client

Sometimes, financing considerations weigh most heavily in choosing a bank. For example, the client may choose the bank willing to provide the financing on reasonable terms.

Selecting an Attorney

Many considerations in selecting a bank also apply to selecting an attorney. The practitioner can help in shaping an important and probably long-term relationship. Factors to consider include personal compatibility, experience, ethics, philosophy, competence, aggressiveness, reputation, fee structure, and availability when needed.

If the client has an established relationship with an attorney, the practitioner usually encourages continuation of that relationship so long as the attorney or his firm can provide the services needed. However, it may become necessary to seek an attorney who specializes in the client's industry. References should be checked if the client or practitioner is not well acquainted with the attorney or his firm.

Selecting Insurance Agents

When a client starts a new business, it may be necessary to use several representatives in securing complete insurance protection, since individual agents may not provide the full range of protection. Practitioners can assist clients in selecting the appropriate coverage and carrier. Insurance coverage may include property and casualty, liability, business interruption, automobile, officers' or key man life, worker's compensation (often provided by a state agency), group life and health, and accident and disability.

Reviewing Legal Documents

When assisting a client in reviewing legal documents associated with starting a new business, the practitioner needs to avoid giving legal advice. These documents may include the following:

- Articles of incorporation, by-laws, organizational minutes, and stock certificates
- A franchise agreement
- A partnership agreement
- A retirement plan trust
- Buy-sell agreements (These are agreements between partners or stockholders and the organization that provide for the purchase or sale of ownership interests.)
- Union agreements
- Public offering circulars
- Patents, copyrights
- Bond indentures
- Lease agreements for buildings and equipment
- Mortgage security agreements
- A trade name affidavit

Meeting Government Regulations

The client often relies on the practitioner to provide guidance in complying with numerous registration and licensing requirements. Among the many items to consider are the following:

- Federal tax identification number
- State tax identification number
- City/county tax identification number
- Unemployment tax determination filing
- Sales tax licenses
- Public health licenses
- Fire, safety, and zoning restrictions
- Consumer Credit Protection Act
- Special-use permits

Planning—Operational Considerations

Management Information and Accounting Systems

Effective decision making by management depends on appropriate and accurate management information and accounting systems. These systems are designed according to the nature and size of the business, the sophistication of management, and the unique needs of the client. General reports and exception reports are particularly useful since they can be modified to suit any client or situation.

Cost accounting systems should satisfy the needs of the business. At a minimum, they need to separate and analyze fixed and variable costs to provide a basis for forecasting cash needs and determining break-even points.

Almost every business can now afford computerized management information systems, and they are appropriate for many firms. Practitioners can advise clients about computer feasibility, selection of software and hardware, staff training, and follow-up. Some typical applications are for payroll, accounts receivable, accounts payable, inventory control, and general ledger and financial statements. Some clients, of course, may need customized software modifications to solve a unique problem.[3]

Marketing

Regardless of the quality of its product or service, a business is not likely to succeed unless the owner carefully considers various aspects of marketing. Most important is determining if a need for the product or service exists. The owner can usually make this determination by using published industry information, including industry sales forecasts; consumer opinion surveys; or previous personal experience in the industry.

The elasticity of demand, along with the policies of the competition, affect pricing. The client can use low prices to gain market share, set high prices to achieve a greater profit margin, or adopt a mid-price strategy to achieve a combination of market share and profit margin.[4]

The business owner also needs to choose sales methods. Alternatives include sales through catalog, telephone solicitation, outside representatives, and direct mail. The practitioner can assist the owner in analyzing the cost-effectiveness of each method.

Advertising, another vital aspect of marketing, considers the target market, pricing policy, industry norms, and advertising cost. Advertising vehicles include direct mail and ads in the print media (mass market and trade), radio, and television.

Personnel Policies

Often the single factor that gives a business its competitive edge is its personnel. For many businesses, therefore, decisions regarding the se-

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3. For additional information on common business applications, see MAS Technical Consulting Practice Aid No. 4, *EDP Engagement: Software Package Evaluation and Selection* (New York: AICPA, 1984).

4. For information on product pricing, see MAS Small Business Consulting Practice Aid No. 5, *Assisting Clients in Determining Pricing for Manufactured Products* (New York: AICPA, 1985).

lection, number, and skills of employees become very important and require careful consideration.

Compensation policies are of special concern. Compensation alternatives include salaries, bonuses, commissions, profit-sharing, or a combination of methods. Incentive compensation can be particularly effective in motivating employees. Additionally, employee discounts are often used, or the company's product may be offered to employees at cost or at cost plus operating expenses. Pensions and stock options can also encourage personnel retention.

Hiring consultants and independent contractors rather than permanent employees may be appropriate in some circumstances. It can avoid certain employee costs, such as nonproductive time and fringe benefits. Furthermore, the Tax Equity Finance Retirement Act of 1982 (TEFRA), through its changes in retirement benefits available to owners of small businesses, has inspired the growth of a relatively new industry. The possibilities may include leasing individual employees or contracting with an outside firm for an entire staff. For a fee, these outside firms hire a company's employees and pay all their benefits.

Employee ambivalence is often the cause of morale problems. A policy manual can reduce misunderstandings and assure fair and impartial treatment. Similarly, an employee training program set up before opening for business, and maintained on a continuing basis, can be instrumental in advising personnel about policy and in developing their skills.

Plans for Continuity of the Business

The prospective new business owner needs to consider a plan to preserve the business and its value. This plan may ensure continuation of the business in the event of the owner's retirement or death. For example, it can provide for enough liquidity to assure continued operations. A closely held business is generally a very illiquid asset. A plan can provide for succession of management or ultimate liquidation or sale.

Selling a closely held business is more difficult if the active owner cannot participate in the orderly transfer. A business without its key manager or founder may have a lesser value. On the other hand, a plan can provide a method for establishing a value for redemptions or transfer of equity ownership. Funding this plan needs to be strongly considered.

In addition, the owner needs to consider a qualified plan for his retirement early in the course of a new business. Future retirement benefits should be funded as earned.

Owner Compensation

Many individuals wish to start their own businesses so that they can enjoy the freedom and perks they believe will become available when they are in control. Practitioners can assist new entrepreneurs in understanding the types of compensation available under different forms of ownership, as well as their costs and tax effects.

A sole proprietor will have tax deductions only for items considered necessary to produce income. Costs in this category include the business-related use of an automobile, entertainment, membership in clubs, and travel. If the business is conducted from the client's residence, he may, under certain circumstances, deduct part of the cost of maintaining that residence. Retirement benefits, self-employment taxes, and health and dental insurance can provide some tax benefits under other sections of the tax laws, but these are not considered business-related deductions. Wages paid to family members may not be subject to payroll taxes and can be the basis for covering those individuals under Keogh plans, IRA benefits, and in the case of children, some income-splitting benefits. Generally, fringe benefits available to an individual are also available to a partner.

Corporate operations provide additional benefits to the owners because stockholders can become employees of the corporation. As such, the corporation pays salaries and payroll taxes. The stockholder-employee can receive fringe benefits, such as life insurance, health and dental insurance, disability insurance, medical-cost reimbursement, and retirement benefits on a nondiscriminatory basis. Loans between stockholder-employees and the corporation in either direction must bear interest and be repaid. Limitations and regulations of such transactions are beyond the scope of this practice aid.

Cash Flow

Poor cash flow has contributed heavily to many business failures. A business needs cash on demand for fixed requirements, such as rent or mortgage costs, salary, debt payment, and capital improvements. The owner also needs to consider variable costs. Therefore, a cash-needs forecast is very useful.

With the practitioner's help, the owner can establish purchasing policies to help assure a balance between capital required and adequate supplies. Such policies include establishing credit terms with each supplier.

Inventory Control

Inventory control is vital to any business involving sales or manufacturing. Methods of control vary according to inventory size, value of each item, and so on. Common methods include age coding of price tags, perpetual inventory control, staple stock, and stock balancing.[5]

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5. For information on inventory control, see MAS Small Business Consulting Practice Aid No. 4, *Effective Inventory Control for Manufactured Products* (New York: AICPA, 1985).

Effective inventory policies and procedures allow the client to coordinate customer demand (or shipping schedules) with supplier deliveries. Businesses that maintain proper levels of inventory can operate more economically, but they have related costs for items such as interest expense on the inventory investment, storage space, security, theft losses, product deterioration, insurance, and handling. An important goal of inventory management is to balance these costs of carrying the goods with the efficiency of always having on hand goods purchased at an economic cost.

Lease versus Purchase

An alternative to equity and debt financing of equipment or real estate is leasing. A lease can minimize the initial costs incurred by the business, even though the lease cost may ultimately be greater than a purchase. Since the property is owned by the lessor, flexibility in its use and renovation may be limited. But, unlike purchased property, leased property provides the business with the ability to return property based on future activities and plans. Lease terms and options can vary significantly, and the client and his legal representative need to review them to assure that the requirements and risks are appropriately considered.

A lease-versus-purchase decision considers the needs and debt-service requirements for the initial operating equipment and real estate, as well as the working capital needed to finance accounts receivable and inventory during the period of anticipated growth.

Sources of Financing

Along with a lack of management skill and an insufficient commitment of time, inappropriate financing and undercapitalization are the most common reasons many new businesses fail.[6] Thus, determining the amount and type of financing ranks as one of the most important activities in starting a new business. The forecast and projections prepared during the engagement provide the practitioner with indications of the client's capitalization and financing needs. Sources of original and continuing financing include equity and debt financing.

Equity financing. If the client has the cash necessary to start the business, it may be the best available source. Self-investment eliminates the disadvantages of debt financing, but it may not maximize the rate of return on investment to the owner.

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6. For additional information on financing a business, see MAS Small Business Consulting Practice Aid No. 1, *Assisting Small Business Clients in Obtaining Funds* (New York: AICPA, 1982).

Sale of ownership interests (equity) in the business is another source of financing. The advantages can include—

- Avoiding the regular drain on cash to meet interest payments.
- Avoiding periodic payments on principal.
- Allowing investors to actively assist the client in the business and with potential customer contacts.

These advantages may be offset somewhat by the disadvantage of giving up a portion of ownership. The client should not enter an ownership agreement without sound professional advice. If financing through equity, the client needs to seek legal counsel regarding national and state security laws.

Debt financing. Borrowing is a common means of financing a small business. Working capital may be raised by utilizing—

- Personal loans to the client, which may be secured by business or personal assets.
- Loans to the client or the business from family or friends.
- Advances from customers.
- Loans from equipment manufacturers or suppliers.
- Loans from financial institutions.
- Loans from venture capitalists.
- Loans from factor lenders.

Loans from financial institutions may be either long- or short-term and may be made by a bank alone or by government and private agencies whose role is to help small businesses get started. Among such agencies are the Small Business Administration (SBA), the Small Business Investment Corporation, the Minority Business Development Agency (MBDA), local chambers of commerce, and the Minority Enterprise Small Business Investment Corporation (MESBIC).

The client might also consider securing a line of credit, as opposed to term loans. The line of credit allows for borrowing on an as-needed basis and can be coordinated with working capital needs.

Forecasts and Projections

Financial forecasts and projections are very important elements of business start-up engagements, since they provide the probabilistic models for future events on which financial and planning decisions will be based. Practitioners prepare projected balance sheets, income statements, and cash flow statements for both short- and long-term periods. Microcomputer-based spreadsheet programs enable practitioners and clients to evaluate a great number of "what if" scenarios in a short time, without great expense. If practitioners provide forecasts or projections, they need to be familiar with AICPA pronouncements on this subject.[7]

Records Retention

One of the questions most frequently asked of practitioners is "how long should I keep various business records?" There are generally recommended retention periods, based on the year tax returns are actually filed, although some variation may be found among various states. Exhibit B-2 lists typical retention periods for common business records.

Final Report

The practitioner needs to work closely with the client throughout the preliminary survey, fact-finding, analysis, and planning and preparation phases and assist the client in reaching decisions at each step. Preliminary communications at these stages can be written or oral.

At the completion of the two planning and preparation phases, the practitioner may want to present a more formal written summary. The final report to the client is a summary of information communicated at various times during the engagement, together with the practitioner's recommendations. If the report is oral, the practitioner may wish to document the conclusions reached and the recommendations made for his files. In many cases the final report also contains the implementation plan (discussed next).

Implementation

The implementation phase of a business life cycle is that critical period of time between completion of the detailed planning and preparation for business operations and the date the business actually begins. It is important to develop a complete and detailed implementation plan for putting this business plan into effect. An implementation plan can be as simple as a checklist of tasks and the time frame for accomplishing them. In preparing the implementation plan, the client, assisted by the practitioner, determines the tasks and the target dates for starting and completing them. Exhibit B-3 is an illustrative implementation plan checklist.

A contingency plan is an important adjunct to the implementation plan, since unpredicted events may occur. For example, the client may

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7. Refer to Statement on Standards for Accountants' Services on Prospective Financial Information, *Financial Forecasts and Projections* (New York: AICPA, 1985).

miss some target dates and may find some tasks impossible to accomplish as planned. A contingency plan allows for timetable slippage and provides alternative means for accomplishing tasks. In effect, it is the implementation plan's "what if" scenario.

If the client has been particularly reliant on the practitioner for recommendations, the practitioner needs to begin urging more independent decisions at this point and assuming more of a coordinator-advisor role. As noted previously, the ultimate success of the proposed venture may well depend on both the quantity and quality of the client's hands-on experience gained during the engagement.

Engagement Follow-up and Ongoing Support

The first few months of a business's operations are a crucial time. During the start-up period, operations need to be monitored closely. This is primarily the client's responsibility as the owner and usually the manager of the business. However, the practitioner can play an important role by being available for consultation about events or trends. The practitioner can help the client understand these occurrences and, very important, advise him about taking corrective actions in a timely manner.

The follow-up assistance can take the form of regularly scheduled progress meetings. At these meetings, the client and practitioner review actual versus budgeted financial information, examine key operating data, and discuss other matters.

Once a business has successfully completed its start-up period, the owner may have a natural tendency to become complacent and allow operations to take their course. Such inaction can seriously impair a business. Practitioners can encourage clients to revise and extend business plans, ensure compliance with established policies and procedures, and revise policies and procedures as necessary. The business owner also needs to remain alert to business conditions and developments in the community and industry.

APPENDIX A

Client Acceptance Considerations

A client usually initiates an engagement by requesting assistance from a practitioner. In deciding whether to accept a client, a practitioner considers the request for service in light of his own standards, policies, and capabilities. If a prospective client requests services, the practitioner might ask the following pertinent questions:

1. Who referred the prospective client?
2. Has the prospective client previously engaged another practitioner and, if so, why is a new one sought?
3. Is the prospective client seeking to establish a continuing relationship with the practitioner or asking for one-time-only assistance?
4. Does the client currently own another business?
5. If so, what is the nature of the client's current business?
6. What is the financial history of the client's current business?
7. Were there any earlier business ventures, and what resulted from them?
8. With whom does the client bank?
9. What law firm does the client use?

APPENDIX B

Reference Information

Exhibit B-1

Comparison Chart of Organizational Forms

Characteristic	*Sole Proprietorship*	*Partnership*	*Regular Corporation*	*S-Corporation*
Simplest form	x			
Limited liability		x[1]	x	x
Perpetual existence			x	x
Ease in transferring assets between entity and owner	x	x		
Ease in transferring ownership interest			x	x
Good vehicle for real estate sale	x	x		
Ease in transferring some income to lower tax rate	x	x	x	x
Feasibility of Retirement plan	x	x	x	x
Group medical insurance plan			x	x
Medical reimbursement plan			x	
Group life insurance plan			x	x
Tax accounting methods				
Fiscal year[2]		x	x	x
Cash, accrual or hybrid	x	x	x	x
Inventory valuation	x	x	x	x

1. Limited partners only
2. Subject to limitation

Characteristic	*Sole Proprietorship*	*Partnership*	*Regular Corporation*	*S-Corporation*
Losses when dissolved deductible as ordinary loss (IRC Sec. 1244)			x	x
Sale of equity interest taxable as capital gains		x[3]	x	x

3. Unrealized income may be taxed at ordinary rates

Exhibit B-2

Illustrative Records-Retention Policy

Number of Years to Retain	*Type of Record*
2 Years	Budgets and cash projection, expired licenses
3 Years	Bank deposit slips, bank statements, bills of lading, cancelled checks (other than for payroll taxes), credit memos, employee expense reports, interim financial statements, freight bills, internal work orders, inventory lists, sales invoices, cash register tapes, purchase invoices and supporting documents (except for permanent assets), petty cash vouchers, production and sales reports, expired bonds and insurance policies, time cards and hourly time reports
4 Years	Payroll tax checks, payroll journals, W-2 and W-4 forms, annual earnings records, payroll tax returns, corporate tax returns
6 Years	Accounts receivable and payable subsidiary ledgers, collection records, cash accounting records, insurance records and reports (accident, fire inspection, group disability, and so on), building and equipment cost records, leases and maintenance records, personnel records
Permanently	Auditor's reports, annual financial statements, general ledgers, cash receipts, disbursements, purchase sales general journals, pension and profit-sharing agreements, actuarial reports, IRS approval letters, corporate charter and by-laws, minutes, stock records, legal agreements, copyrights, patents and trademarks, pension and profit-sharing tax returns, related cancelled checks

Note: The company should establish a records-retention policy consistent with its industry norm and its location.

Illustrative Implementation Plan Checklist

Target Date	*Completion Date*	*Activity*
		1. Establish the legal framework for the form of organization chosen, including tax identification numbers, regulatory agency registration, licenses, and so on.
_____	_____	2. Arrange for financing and financial report.
_____	_____	3. Employ and train personnel.
		4. Arrange for the following physical resources:
		Plant and equipment
_____	_____	Site selection
_____	_____	Zoning
_____	_____	Equipment acquisition
_____	_____	Inventory
_____	_____	Operating supplies
_____	_____	5. Develop accounting information systems and procedures, including methods of monitoring.
_____	_____	6. Develop the organizational structure and personnel policies and procedures.
_____	_____	7. Implement the marketing plan, including initial publicity.
_____	_____	8. Arrange for a grand opening.

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