WHITEPAPER

for

SimCrest, Inc.
Cash Basis Accounting

(Made for Microsoft Dynamics NAV)

Last update 8/17/10 for Cash Basis 2010 R2

TABLE OF CONTENTS

SimCrest's Cash Basis Accounting

(Made for Microsoft Dynamics NAV)

This document will explain how SimCrest's Cash Basis Accounting works and how the users should setup and maintain Microsoft Dynamics NAV) in order for the system to calculate the account correctly.

A SimCrest product

Cash Basis Accounting has been developed by SimCrest, Inc. a certified Microsoft Dynamics NAV Business Partner located in Allen, Texas. Cash Basis Accounting is a Microsoft approved solution and the granule (14,020,365) can be purchased through Microsoft. The product will also require a license key file from SimCrest in order to work.

Cash Basis versus Accrual Basis

Cash Basis and Accrual Basis differ in the manner in which they deal with the issue of when to recognize revenues and expenses. The Cash Basis focus is, as its name implies, on the flow of cash. That is to say, whenever cash is collected, revenue is recognized as having been earned. A similar basis for the recognition of expenses is used, namely whenever cash is disbursed the related expense is recognized as having been incurred.

In Accrual Basis, the test for revenues is when it is earned. Revenue is generated as a result of a business's performance in an economic exchange. That is to say a business enters into a contractual agreement to exchange a performance for a consideration, which will culminate in the receipt of cash. When it completes that performance, it is entitled to receive that cash; it has earned it as revenue. At that time revenue is recognized.

The recognition of expenses follows in a similar manner. The Matching Concept in accounting makes it imperative that we match all expenses against the revenue that they help to generate. Expenses then follow a similar pattern to that of revenue. When expenses are matched in this manner, they are said to have been incurred. At that moment, they must be recognized as an expense. This recognition is independent of the actual payment. Cash is not the criteria for recognition.

Cash Basis Accounting

Microsoft Dynamics NAV is an accrual basis system, thus the cash basis cannot be calculated in the standard version. This product will enable Microsoft Dynamics NAV to calculate in both Accrual and Cash Basis modes.

Calculating Cash Basis

In order to calculate the accounts on a cash basis a batch job must be run. The batch job will populate cash entries into a designated table and from the Chart of Account in NAV the Net Change and Balance at Date can be shown and calculated for specific periods. Each time the calculate cash function is run, the prior system created cash basis GL entries are deleted and the table is refreshed.

Using Account Schedules a new option is available in the column layouts called "Ledger Entry type" This allows a selection of Cash GL Entries to enable the user to produce Financial Statements on a cash basis. It is important to point out that as opposed to Microsoft Dynamics NAV's automatic calculation of accrual basis numbers, cash basis numbers must be calculated using the batch job.

How does it work?

Customer/Vendor transactions

The product will find all payments and refunds made and find the corresponding documents that were applied to or from the payments or refund.

Whenever a document is found, the product will calculate the percentage that has been applied and calculate the cash basis for each line on the document.

For instance, if an invoice has been under paid, the cash basis for each line on the invoice will decrease accordingly.
Example:
Invoice 1000 for $1,500

Account No.	Amount
1000	500
2000	1000

If the payment applied to this invoice is only 750, the resulting cash basis will be:
Cash Basis

Account No.	Amount
1000	250
2000	500

From the above it is obvious that the product will actually need access to the sales and purchase documents (and lines) in order to calculate the cash basis. That is why it is not allowed to delete posted sales or purchase documents (see the section Assumptions and Limitations) and also why it is not allowed to post transactions via the journal form to customers and vendors (except for payments and refunds).

The product will calculate the cash basis for all payments and refunds as of the posting date of the payment or refund. If the payment or refund has been applied to documents, the offsetting entries are booked based on this application. If the payment or refund has not been applied, the offsetting entry will be booked to an "overpayment" account that is selected in the GL setup menu. When the payment is later applied, the entry is updated from the overpayment account to the corresponding accounts based on the application. This offsetting entry must be made in order to keep the balance sheet in balance with an offsetting entry to the cash transactions, and to recognize the sale or expense based on the posting date of the cash payment or refund.

For Credit Memos and Invoices that are applied to each other (and not related to an actual cash transaction) the recognition is based on the application date. All entries applied to payments or refunds are recognized based on the payment or refund date, and not any posting date of the documents themselves.

- Sales are recognized at the time of payment or application on sales invoices and credit memos.
- Expenses are recognized when the purchase is paid or applied on purchase invoices and credit memos.
- Inventory is not calculated as purchases are "expensed" as paid.

When the cash basis finds the applied document, if the lines on the document are
- G/L accounts, these are the accounts that are used
- items,
    - o the product will look at the "General Business Posting Group" and the "General Product Posting Group" for the line and get the correct G/L account from the General Posting Setup (GPS) table
    - o sales or sales credit memo account for sales documents,
    - o COGS account for purchase documents.
- Resources
    - o the product will look at the "General Business Posting Group" and the "General Product Posting Group" for the line and get the correct G/L account from the General Posting Setup (GPS) table
    - o sales or sales credit memo account for sales documents
- Fixed Assets,
    - o the product will look at the FA posting group
    - o then based on the FA posting type of the document line
    - o find the correct GL account.

This also means that if changes are made to the Sales, Sales Credit Memo and Cost of Goods Sold accounts in the GPS table, or the FA Posting setup GL accounts, then the next time the

cash batch job is run the cash numbers will be calculated in these new accounts (see the section Assumptions and Limitations).

GL Entries

As customer and vendor entries are posted as an accrual and are awaiting cash income or outlay, they are picked up based on applications. All other postings to the GL are picked up by the calculate cash as of the posting date of the GL entries in the G/L Entry Table. If there are any GL journal entries made via the standard GL journals that should not be included on the cash basis, the cash adjustment journal should be used to enter offsetting entries to zero out the cash basis effect.

Making Manual Cash GL Entries

During the initial installation, and also occasionally throughout the year, manual adjustments to the cash basis may be needed. A new table and form called "Cash Adjustment Journal" have been created to allow users to enter manual entries to the cash basis that will have no effect on the accrual basis. The lines in this journal are stored in a separate table than the Cash GL entries. The lines in the Cash Adjustment Entries are not automatically updated to the Cash GL entries, but are captured during the "calculate cash" batch job, thus it is mandatory to run the calculate cash batch job after entering manual entries to see the impact on the cash basis.

All entries made to this table must remain in the table and should not be deleted. Deletion of the entries in this table will mean that the next time the calculate cash is run, these entries will no longer be found, and thus will not be adjusted as part of the calculate cash function.

System Setup Areas

Setup GL Accounts

The accounts used for AR, AP, and Inventory should have "direct posting" no. This will ensure that these accounts in the cash basis remain at zero, as AR, AP and Inventory are only posted via documents that will be skipped in the calculate cash batch function. Any manual journal entries to GL accounts will show up both in accrual and cash, and entries that should not impact cash will need to be offset in the cash adjustment journal as noted above. This is easier to find when you have specific accounts setup to be used for manual entries in these areas that need to be adjusted out of cash transactions.

In the General Ledger Setup screen two accounts need to be selected: Retained Earnings and an Overpayment Account.

- The Retained Earnings account is used to allow system generated entries to close the prior year income statement to Retained Earning when the cash basis is calculated and the prior year is not yet closed.
- The Overpayment Account is used to post overpayments in A/R and A/P (payments made or received that have remaining amounts not applied)
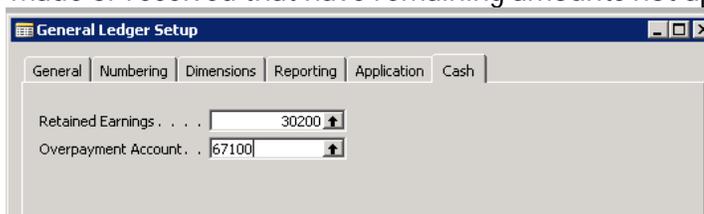
# Setup for Payment terms discounts and tolerances

There are a few setup areas that need to be discussed along with the impacts on Cash Basis.

General Ledger Setup
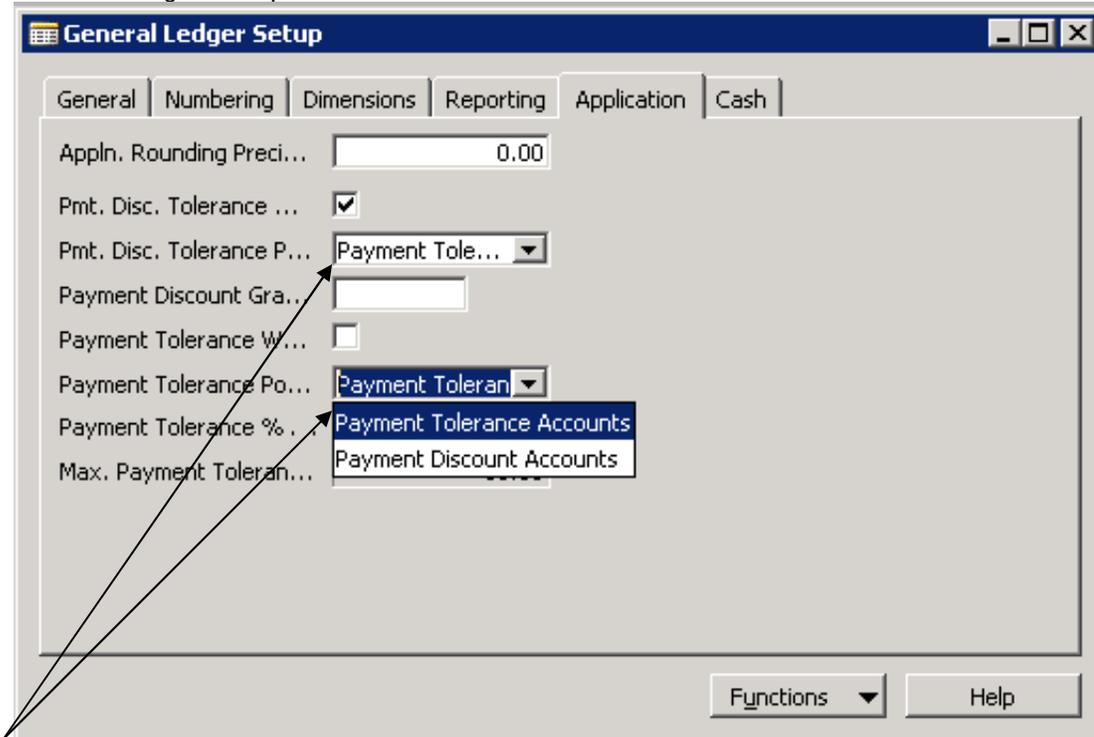
The GL setup allows for posting of payment discounts and tolerance to go to the same accounts, or separate accounts. It is recommended that the setup be to the Payment Tolerance Accounts here.

Customer and Vendor posting setups, is where you specify the GL accounts.
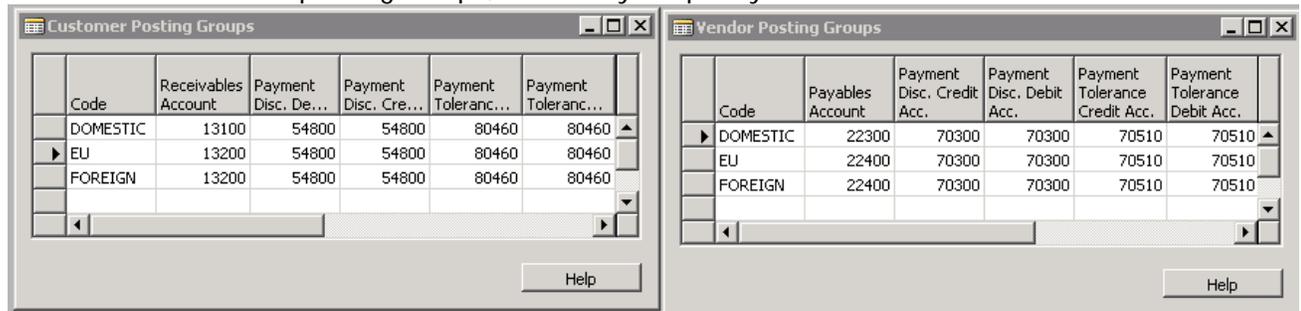
There are two critical points to note, and the setup in the GL setup and on the posting group setups must match.

1. Debit and Credit GL for discount and tolerance for the cash basis should be set to the same accounts. The cash basis will only look at the customer debit accounts and the vendor credit accounts.

2. If on the GL setup, the posting is setup to go to the discount accounts, then on the posting group's setup, these 4 accounts must all go to the same GL account.
   a. Example, if setup on GL setup is for tolerance to post to the discount accounts, and on the posting group setup, discounts go to 54800 and tolerance go to 80460, then cash vs accrual will be out of synch
      i. Accrual will post all to the discount account 54800
      ii. Cash will post based on the posting setup for discounts to go to 54800, and tolerances to go to 80460.
   b. Recommended setup
      i. on GL setup is to set tolerance to go to tolerance accounts
      ii. on posting setup,
         1. discount debit and credit MUST be the same number as each other
         2. tolerance
            a. debit and credit MUST be same number as each other
            b. can be same or different account than the discount account

Setup Account Schedules

Account Schedules are setup as per standard Microsoft Dynamics NAV for the rows and also for Analysis Views. All dimensions are able to be used as with standard NAV functionality. A separate table has been created to store the cash basis entries for the analysis views.
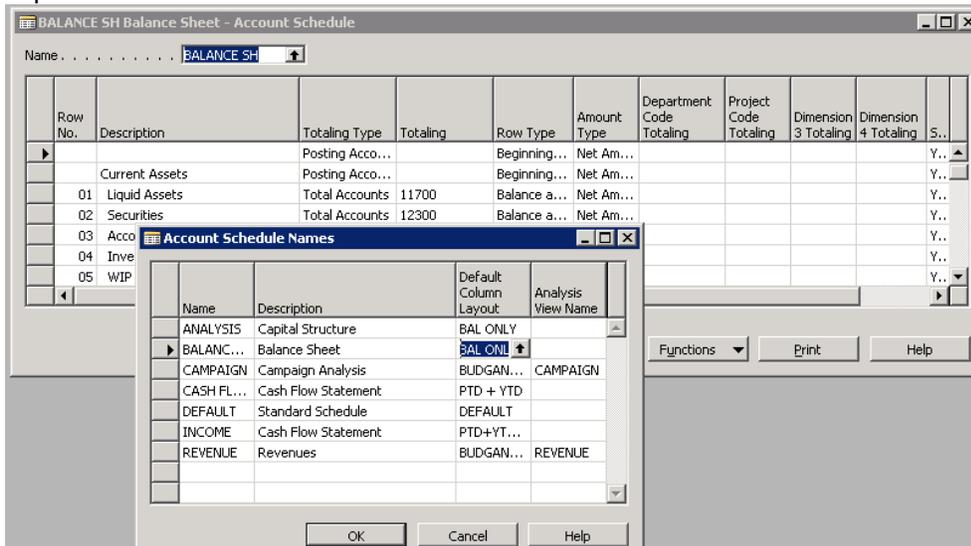
The column layout is where the options are for the setup of the account schedule to look to the cash basis entries.

The column for the "ledger entry type" can be selected to show GL entries, GL Budget Entries or Cash GL Entries. The addition of the cash GL entries option allows you to setup account schedules to view the cash against budgets, or the cash and accrual at the same time.

Notes on initial implementation

Setup Initial document imports

There is a setup only available through the GL setup table "Allow Initial Doc. Posting" to allow posting of invoices and credits to vendors and customers via the journals. Please note, the default setup is NO and should only be set to yes during initial data conversion if there is a need to import open AR and open AP via journals instead of through posting of individual invoices

and credit memos. It is recommended that actual invoices and credit memos to the actual GL accounts be used if at all possible.

If allow initial doc posting is allowed, the calculate cash will only be able to pickup half of the entry, the GL offset, and not the application of the invoice or credit as there is no posted document for the application. (See section below for more information on initial data conversion issue for journal entries for open AR and AP)

Initial document posting of open AR and AP

Many times on initial data conversion for implementation, journals are used to create open AR and AP balances, and the offset GL is normally a clearing account instead of the actual Sales and or Expense accounts. The offset of the clearing account is normally due to the fact that the opening GL balances are brought over, thus a clearing account is used so as not to overstated sales or expenses by posting open AR and AP to the actual GL accounts. These open balance entries must have manual entries entered to adjust the opening balance and also the payments since the calculate cash cannot find the posted document related to the payment and invoice to make the other half of the entries.

It is recommended that actual invoices and credit memos to the actual GL accounts be used if at all possible. By posting the actual sales and purchase invoices and credits, the calculate cash will find the applied entries as they are paid and no manual entries will be required.

If journals must be used for open AR and AP, then it is recommended that:
- Use document numbers in the opening AR and AP journals to make entries easy to identify, such as "Open Bal XX".
- An excel file be kept of the opening balance entries for AR and AP and their corresponding actual GL accounts for sales and expenses
- Use of the excel file to keep track of the amounts that need manual entries as the invoices and credits are paid and or applied.

Example, a journal is created for an open invoice to a vendor with an offset to a GL clearing account or the actual expense.
- While the invoice is open (not paid) the calculate cash will only find the entry to the GL account
  - This means that your cash basis will be out of balance as only half of the transaction is found.
  - A manual entry will need to be made to reverse the GL entry in cash basis as the invoice is still open and should not be recognized as an expense yet.
- When the invoice is paid, the calculate cash will make the entry of the payment to the bank, but as it cannot find the related applied document, the entry to the expense is not picked up.

- o This means that your cash basis will be out of balance as only half of the transaction is found.
  - o A manual entry to the actual expense account is needed
- Take the scenario of posting to a clearing account
  - o In this example, if the invoice is posted and paid in the same month
    - Then the balance is showing in the clearing account and not the actual expense.
    - At a minimum, a month end entry to move the amount from suspense to the actual expense is required.
  - o In this example, if the invoice is posted in one month and paid in a different month
    - Then the cash for each month is off, and the actual expense needs to be recorded.
    - manual entries are needed
      - In the invoice posting month to zero the entry to the suspense account,
      - In the invoice payment month to the actual expense account to recognize the expense.
- Take the scenario of posting to the actual expense account
  - o In this example, if the invoice is posted and paid in the same month
    - Then the cash for the month is OK with no manual entry needed
    - But per day will still be off
  - o In this example, if the invoice is posted in one month and paid in a different month
    - then the cash for each month is off, but is back in balance at the end of the 2nd month
    - If you need to balance per month, a manual entry is needed
      - In the invoice posting month to zero the entry to the expense account,
      - In the invoice payment month to the expense account to recognize the expense.
- In either scenario, it is a very manual task to keep track of the cash entries that are needed if the payments will span over a few months.
  - o This is why it is recommended to post the actual sales and purchase invoices and credit memo.
  - o After posting of the actual documents, one GL journal will be needed to move the duplication of the expense and or sales amounts. This entry will be captured in the accrual and cash balances, and no further manual reviews are required.

Initial Calculate Cash and Opening Cash Adjusting Entries

The first time you run the calculate cash basis after implementation, manual entries will need to be made to get your beginning cash basis into balance.

Run the calculate cash then use account schedules or chart of accounts to review your balance sheet and income statement.
Make adjusting entries as needed, then run the calculate cash again to review.

The User section of the Installation and Users Guide provides an overview of the functionality and making manual adjustments.
Below are some reasons manual entries may be needed:

This product calculates based on the application of the document type. Transactions to customers or vendors with a blank document type are skipped as the system does not know how to calculate the application.
- After implementation of this module, the system will not allow posting of customer or vendor entries in a journal with a blank document type.
- For clients that are already on NAV, a form and table have been created to allow the implementation partner to view and update Customer and Vendor ledger entries with blank document types.
    - Use of this form will update the Customer or Vendor Ledger entries, and Detailed customer or vendor ledger entries with the document type.
        - Run the calculate cash basis after updating the document type to review the net effects and determine if additional entries are needed
    - Manual entries may also be used to account for these transactions to balance the opening cash basis.
        - The entries to the GL accounts will be made by the calculate cash, but the offsetting entries related to the customer or vendor entry with a blank document type will not be picked up.
        - As long as the entry is not a payment or refund with a remaining balance, manual entries can be made as a one-time cash adjustment entry.

The product will not be able to calculate applications if transactions (invoice, credit memo, finance charge or reminder charges) are posted to a customer or vendor via the journals.
- As opening balance entries are often imported via journals for new implementations, a setting is available in the GL setup table "Allow Initial Doc. Posting". (this must be accessed from the table and is not available on the form)
- This should be set to yes in order to import opening balance entries, however a manual adjustment to the GL will be required to book an offset as only a one sided entry to the GL account will be made. Corresponding manual entries will be required as the initial invoices are paid.
- After implementation, or for clients that are already on NAV, the "Allow Initial Doc. Posting" setting should remain disabled (have a value of blank or no in the table).
- For clients that have already been running on NAV prior to implementing the cash basis, manual entries will be required for any journal entries that were made to customers or vendors that were not payments or refunds.

Opening balances will need to be confirmed on the cash basis. On the initial implementation, the cash basis will require manual entries to properly capture the cash GL opening balances. All entries that are made via GL journals are automatically written to the accrual, and the calculate cash will capture these entries. Therefore, any GL entries that should not be reported on the cash basis will need manual cash adjusting entries to remove those values.

Existing NAV clients with journal postings to customers or vendors

See notes above about the form and table to be used to populate any existing customer or vendor entries that have a blank document type. If the entries are fully applied, no additional entries may be needed. Or, if any outages are found, then initial manual entries to get the beginning cash balance are all that may be needed. If any entries are open, they will need to be captured and kept in a file similar to the above examples for the open balance transactions.

As these entries are paid or applied, the calculate cash will find and make the entries for the cash income or outlay, but as there is no document related to these customer and vendor postings, the offsetting income and expense cannot be found.

It may be preferable to post journal entries to offset these open customer and vendor entries, and apply them. Then create actual invoices and credit memo's to be used for applications on the customers and vendors.

Assumptions and Limitations

Limitations and notes on general functionality

Each time the calculate cash basis function runs, the system deletes the existing cash GL entries and recreates them, and also creates and updates the cash analysis view entries. It looks to the entries in the cash adjustments journal, the customer and vendor entries and applications, and the manual GL entries. The function must do this in order to review all posted entries and applications, since NAV allows users to change allowed posting dates, and allows applications as of prior dates. Since the entries are deleted and recreated, there are a few things to note.

- No posted sales or purchase documents are able to be deleted. If a document were to be deleted the product would not be able to distribute the payment on the accounts.
- If changes are made to the General Posting Setup, General Business Posting Groups or General Product Posting Groups, or the FA Posting setups, the product will calculate the cash on the basis of the new setup, also on entries made prior to the new change.
- The product is only able to calculate on entries made after the installation of the product.
- This product calculates based on the document type for applied entries, therefore postings with a blank document type to customers and vendors are not allowed.
- The product will not be able to calculate applications if transactions (invoice, credit memo, finance charge or reminder charges) are posted to a customer or vendor via the

journals, therefore only payments and refunds can be posted to customers and vendors via journals.

Sales and Purchase Tax

The product is not designed to calculate sales and purchase tax on a cash basis.

- o As rules for sales and purchase tax and cash vs. accrual rules can differ from state to state, clients should contact their CPA or State regarding the legal rules for reporting sales tax on a cash basis, and make adjusting entries as required by law.
- o Explanation of how the system posts sales and purchase tax on cash basis entries
    - ▪ No posting to the cash basis are done until invoice/credit is paid and applied
        - • If invoice paid in full, full amount for sales and tax will be recorded
        - • If invoice is a partial pay, % of amount including tax vs. payment amount to be calculated. This % will be applied to each GL account for sales and also the sales tax amounts.
    - ▪ Overall effect is that the cash basis will remain in balance per cash receipts, but may not comply with specific state laws on cash basis sales tax.
    - ▪ Clients should still check with their CPA or State in regards to how sales tax is to be reported for cash basis, and adjustment journals may still be needed based on state sales tax laws.
- o Use Tax and Cash basis are currently not allowed together.
    - ▪ Standard NAV functionality allows the accrual of Use Tax.
    - ▪ The AP accrual and later cash outlay of payment against the invoice are for the invoice amount only,
        - • no cash outlay is made for the Use Tax payable at time of purchase invoice posting.
        - • Thus, there is no cash basis to recognize
    - ▪ If a user tries to select use tax on a purchase line, an error will be encountered.
    - ▪ If there is a need to calculate purchase use tax and use cash basis, additional custom development in this area will be required.

Invoice and Line Discounts

Standard NAV allows for the entry of invoice discounts (a discount off of the entire invoice or order value) and line discounts (discount related the specific sales or purchase line). Setup and posting of the document on the accrual basis allows the pre-discounted amount to be captured as the sales or purchase value, and the discount amount can be captured into a separate discount account.

The AR or AP and future cash income or outlay are recorded as the discounted amount.
Since the cash basis captures the cash basis at the time of cash income or outlay, the related "net" sales or purchase amount is captured, but the discount is not.

Example
- Sales order or invoice entered for 100, with a 5% discount
- Accrual will post 100 sales, 5 discount, and 95 AR
- Cash receipt of the payment from the customer
  - Accrual records decrease AR 95, increase cash 95
  - Cash basis finds the cash receipt of 95, and the applied invoice, and records 95 cash and 95 sales.
- If it is OK for the cash basis to show the "net" sales or purchase amounts and not the gross purchase or sales and the discounts, no action is required.
- If the intent is to record the 100 sales and 5 discount on the cash basis, manual entries will need to be made.

The outage for the discount account is easy to find simply by comparing the cash vs. accrual balance on the discount accounts. The cash adjustment amount per discount account can then be noted. The offset of this entry will be to "sales".

If only one sales account is used, the offset is also easy to calculate. If multiple sales accounts are used, a custom report can be created, or the data can be copied/pasted into excel to find the amount per general posting group combination setup for allocation to the correct sales accounts.

General Posting setup
Sales and Purchase invoice discounts, as well as line discounts are assigned per combination of posting groups
Sales and Purchase accounts are also assigned per posting group combination

General Posting Setup

Gen. Bus. Posting Group	Gen. Prod. Posting Group	Sales Account	Sales Credit Memo Account	Sales Line Disc. Account	Sales Inv. Disc. Account	Purch. Account	Purch. Credit Memo Account	Purch. Line Disc. Account	Purch. Inv. Disc. Account
EU	MISC	44200	44200	45200	45200	54200	54200	54400	54400
EU	NO VAT	44200	44200	45200	45200	54200	54200	54400	54400
EU	RAW MAT	43200	43200	45200	45200	53150	53150	53300	53300
EU	RETAIL	44200	44200	45200	45200	54200	54200	54400	54400
EU	SERVICES	42200	42200	45200	45200	54200	54200	54400	54400
EXPORT	MANUFACT	44300	44300	45200	45200	54300	54300	54400	54400
EXPORT	MISC	44300	44300	45200	45200	54300	54300	54400	54400
EXPORT	NO VAT	44300	44300	45200	45200	54300	54300	54400	54400

Gen. Bus. Po...	Gen. Prod. P...		Account Name
EXPORT	MISC		

Setup ▼   Copy...   Help

For discount entry, compare each discount account to find adjustment to be made for cash entry.

If only one main sales, account, offset to sales.

No.	Name	Income/Balance	Account Type	Net Change Cash	Net Change	Manual Entry
13100	Customers Domestic	Balance Sheet	Posting			
44100	Sales, Retail - Dom.	Income Statement	Posting	-95	-100	-5.00
45200	Discount Granted	Income Statement	Posting		5	5.00

If multiple sales accounts exist, the user can drill down on GL entries in the discount account to get details per posting group combination for confirmation of each sales account. A report can also be created to summarize this information per the specific customer requirements.

Posting Date	Document Type	Document No.	G/L Account No.	Description	Gen. Posting Type	Gen. Prod. Posting Group	Gen. Bus. Posting Group	Amount
7/25/2010	Invoice	103031	45200	Order 1010	Sale	RETAIL	NATIONAL	5