Tax Question:
What cut-off procedures and controls should I have in place and why are they important for my company?

Facts:
One of the fundamental accounting concepts is the matching principle (see FAQ #171), expenses must match the related revenue. If a sale is recorded in the fiscal period, the expenses related to that sale should also be recorded in the same fiscal period. Cut-off procedures and controls help to ensure that this matching occurs.

Discussion:
At your fiscal year end, cut-off procedures and controls become especially important to ensure the corporate taxes paid are correct. In addition, the matching principle allows for a more objective analysis of profits; by recognizing costs in the same period as the revenue they relate to, the company can compare profit year on year accurately. You should ensure you have cut-off procedures and controls in place to cover the following areas:

- **Cash** - All cheques written should be recorded in your accounting system the date they are written. Controls should be in place to ensure that cheque stubs are filled out and dated so that all cheques written can be recorded before the cheque clears. All deposits received should be recorded in your accounting system the date they are received. Controls should be in place to ensure that all deposits received are scanned or copied before depositing so that they can be recorded in your system at the date received, not the date cleared. This means you will likely have outstanding deposits and cheques each month and will need to prepare a bank reconciliation monthly.

- **Revenues and Receivables** - The company should have a written revenue recognition policy so that all staff know when revenue is to be recognized. Is revenue recognized when the product is shipped or when it is delivered? The revenue and receivable should be recorded in the accounting system according to this revenue recognition policy. Controls should be in place to ensure that this occurs and the sales cut-off is performed correctly. The Accounts Receivable ledger should be kept open a couple of weeks after the year end to ensure all sales are recorded. Any deposits received for work that has not been performed before the year end should not be recorded as revenue but should be reflected as unearned revenue or deposits in your accounting system.

- **Expenses and Payables** – If a sale is recorded in the period, the expenses related to that sale should be recorded in the same period. The wages for producing the item, cost of sales, and selling expenses should all be expensed in the period the revenue is recorded. If your revenue recognition policy is to recognize the sale when it has been delivered, then the cost of delivery should also be recorded in the same period. The company books will need to be kept open for a few weeks after the year end to ensure that all of these items are recorded in the correct period. Supplier invoices will need to be carefully reviewed for the next four to six weeks to ensure that all expenses are recorded in the period they relate to.

- **Prepaids** – If a payment has been made for an expense in which all or a portion of the expense relates to the next fiscal period, this portion of the payment should be recorded as an asset called prepaids in the current year and then expensed in the next fiscal year when the period the payment relates to has passed.

Recommendation:
If you would like to review your recognition policy, cut-off procedures and controls, contact Gilmour Knotts Chartered Accountants for assistance.

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