

BY MELANIE HODGDON

Foundational Flaws

We've all heard this building adage: If you start off with a foundation that's out of level or not square, you'll still be fighting it when you do the roof. In bookkeeping, there are also "foundations," although the consequences of a problem in one may not be as easily or immediately visible. What typically throw business financials out-of-whack are inconsistent record keeping and faulty accounting—and the best remedy is creating tried-and-true procedures and slavishly following them on each and every job.

CLASSIC ERRORS

The following are errors that I see all the time:

1. You get a payment from a customer based on a payment schedule, but you haven't created an invoice yet. You process the payment to get it into the bank, and you figure that you'll eventually get that invoice entered—when you get a spare minute. What you've done is credit Accounts Receivable without recording income. If you never get around to generating an invoice to match the payment to, you'll end up with negative Accounts Receivable and no income reported for that job.

2. You generate an invoice. But when the customer pays, somebody makes a direct deposit in the software, crediting an income account—instead of following a payment process to credit Accounts Receivable. This results in doubling the income (once from the invoice and once from the deposit), but the customer will still appear to owe you because the payment process never occurred.

3. You enter a bill for materials or from a subcontractor. This affects your cost and Accounts Payable. But when you pay the bill, you absentmindedly write a check (perhaps you're at the lumberyard with your checkbook in hand and decide to take care of it), and back in the office, the check is entered and applied to a cost account. This results in doubling the cost (once from the bill and once from the check), and you still appear to owe the entire amount.

4. You dutifully record lump-sum payments to your credit card but either don't know how to record individual purchases, or miss a bunch. The result is a negative balance on your credit-card account, and the loss of potentially thousands of dollars of legitimate business expenses from your financials.

5. You make payments on a truck loan every month and classify them as Vehicle Expenses, an account that

appears on the Profit and Loss. In fact, the principal portion of the payment should be reducing the amount of the loan, displayed on the Balance Sheet.

A related error is made when neither the loan nor the truck is recorded on the financials. The results are that the truck isn't included as a Fixed Asset on your Balance Sheet, the loan isn't included as a Long Term Liability on your Balance Sheet, and your expenses are inflated on your Profit and Loss, making your taxable bottom line smaller, because the loan principal (instead of just the interest) is classified as an expense.

6. You carefully reconcile your bank account each month, matching transactions to your statement. However, you show some transactions for which the bank statement doesn't have a match. You let them slide (after all, you *are* reconciling the ones on the statement), and after several years, there may be dozens of these transactions, all contributing to your apparent cash balance. Let's say a \$10,000 deposit from 2009 never cleared. Then your cash balance is overstated by \$10,000. Or maybe you have \$15,000 in assorted checks and debits over five years; your cash balance is then understated by \$15,000.

The result is more dramatic than that, however. All those uncleared deposits and withdrawals appear on your past years' financials, which can affect your taxable bottom line. Let's say that the \$10,000 deposit that didn't exist (according to your bank) credited an income account. Then whatever year that deposit was made in, your taxable income was overstated by \$10,000. The reverse is true for your debits. At each reconciliation, it's critical to investigate any suspicious-looking uncleared transactions; they could be duplicates or they could even be drawn on the wrong bank account. Clean them up to keep your cash (and financials) accurate.

As errors in a foundation affect the roof, some errors impact your financials and your taxes. Look for odd, lingering unpaid balances, unexpected negative balances, and figures suggesting amounts that are still owed (or that you owe others) when you "know" they're not. If you're not sure how to get your financial records square and level, seek assistance from somebody who can train you in the methods required to avoid those rooftop issues.

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