

Your Bookkeeping

STINKS!

*Why It's Killing Your Business and
Wrecking Your Plans for Retirement*

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www.StinkyBooks.com
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Table of Contents

Introduction	vii
Why Your Current Approach Is Wrong Critical Insight You Need to Survive!	
Your Bookkeeping Stinks—Stinker #1.....	1
My spouse knows a little bit about bookkeeping, so I'll let her handle the books.....	1
Your Bookkeeping Stinks—Stinker #2.....	3
My staff has free time—I'll let them handle the payroll.	3
Your Bookkeeping Stinks—Stinker #3.....	5
My do-it-yourself bookkeeping software generates bad reports and information.	5
Your Bookkeeping Stinks—Stinker #4.....	7
Your chart of accounts has more than fifty accounts listed.	7
Your Bookkeeping Stinks—Stinker #5.....	9
I don't have to reconcile my bank accounts, do I?	9
Your Bookkeeping Stinks—Stinker #6.....	11
What is a profit-and-loss statement? I've never created one.	11
Your Bookkeeping Stinks—Stinker #7.....	13
I've got inventory. I have no inventory control.	13
Your Bookkeeping Stinks—Stinker #8.....	15
It's OK to mix personal and business expenses, right?	15
Your Bookkeeping Stinks—Stinker #9.....	17
My estimating process is a disaster, and I can't create invoices from estimates easily.	17
Your Bookkeeping Stinks—Stinker #10.....	19
What is accounts-receivable management? I have no idea what you're talking about.	19
Your Bookkeeping Stinks—Stinker #11.....	21
I'm in a cash-flow crunch right now. Help!.....	21

Your Bookkeeping Stinks—Stinker #12	23
F-F-F-Fraud?! It couldn't happen to me—could it?	23
Your Bookkeeping Stinks—Stinker #13	25
You mean I should keep track of my fixed assets?.....	25
Your Bookkeeping Stinks—Stinker #14	27
The last time I backed up my accounting data was six months ago.	27
Your Bookkeeping Stinks—Stinker #15	29
My staff still scribbles purchase orders by hand.....	29
Your Bookkeeping Stinks—Stinker #16	31
I owe the bank how much?	31
Your Bookkeeping Stinks—Stinker #17	33
The black hole of business credit cards	33
Your Bookkeeping Stinks—Stinker #18	35
Did I make any money on that job?.....	35
Your Bookkeeping Stinks—Stinker #19	37
My bank needs my financial statements. I'm in trouble now!.....	37
Your Bookkeeping Stinks—Stinker #20	39
I give my accountant a shoebox or file folders crammed with receipts at the end of the year to prepare my business taxes.....	39
Your Bookkeeping Stinks—Stinker #21	41
I just purchased some accounting software. I should be able to set it up myself, right?	41
Commit Yourself to Success!	43
Appendix	45
Appendix A	47
Checklist for Resolving Your Bookkeeping Stinkers.....	47
Appendix B	49
Keeping Score? The Financial Reports You Will Need to Create to Stay on Top of Your Business Finances	49
Appendix C	50
Failure Is for Real	50

Introduction

If you only knew the real story behind the numbers of your business, you would be frightened at the tale it tells.

Too bad you don't know the story, since your books are probably a mess—and getting messier with each passing week.

It's no secret that small business owners like you dislike bookkeeping and finance. Keeping the books for your small business is a task more disliked than eating Brussels sprouts. When it comes down to making a choice between selling your products and services or tracking your finances, which one gets more attention?

You simply don't understand bookkeeping, or maybe you don't want to understand it. However, the choice to relegate the task to the bottom of the "I'll do it later" pile or to delegate it to a friend or family member who knows a little about bookkeeping is a sure recipe for financial disaster.

How extensive are these financial disasters? A survey by the U.S. Small Business Administration showed that 55 percent of businesses reported problems related to their finances or financial issues. (See "Failure Is for Real" on p. 50.)

Why Your Current Approach Is Wrong

Small businesses spend an inordinate amount of time getting ready for their accountants to prepare their annual tax returns. But what about all the other days of the business year that *aren't* tied into tax time? This is where this approach is a complete failure.

You know the drill—take your shoebox filled with receipts to your accountant's office. Wait a month (or more), and then receive a stack of forms several inches high for your review, signature, and mailing. File all these papers away, and repeat the process next year.

Critical Insight You Need to Survive!

But who reviews the financial results of your business with you? Who is there to help you understand critical concepts like "gross profit," "financial ratios," and "cash flow"? Chances are, it's *not* your tax accountant—they have hundreds of other tax returns to crank out. Chances are, it's *not* your bookkeeper, as concepts such as these are beyond his or her reach. You're left standing in the financial void—desperately needing guidance, but not knowing where to turn.

Scott Gregory

In reality, these very concepts can and will provide the guidance you need to effectively manage the financial affairs of your business. It's really no different from keeping a scorecard when you're playing golf. Your business scorecard tells you where results have exceeded your expectations or, more importantly, where you've scored a bogey and need some corrective action.

I'm not suggesting that you become an accountant and obtain an intricate knowledge of debits, credits, and accounting regulations. I am, however, emphasizing the fact that you will need to be fluent in some of the language of accounting and bookkeeping. And if you don't have the time to become fluent, then it's imperative that you work with someone who is. The survival of your business may depend on it!

In the following pages, you'll gain a greater understanding of some of the common problems found in the bookkeeping systems of small businesses and what you can do to take corrective action. How many of these problems exist in your business?

Your Bookkeeping Stinks—Stinker #1

My spouse knows a little bit about bookkeeping, so I'll let her handle the books.

Let's see if this philosophy makes sense. If your spouse knew a little bit about knee replacement surgery, you'd want her to perform the operation?

Naturally, many small businesses are looking for ways to save money, and not having to pay someone for bookkeeping services is certainly one way to save. But if there were ever a case of being pennywise and pound foolish, this is it.

The various business tracking scorecards I'll discuss later are all built on a common premise: that the information going into your books is timely and accurate. In many cases, taking the spousal approach to keeping the books is neither timely nor accurate. But it *is* inexpensive.

I can't emphasize enough the necessity of adding a competent bookkeeper to your team. Don't immediately assume that you have to put someone on your payroll full time. In many business settings, the use of an experienced part-time bookkeeper will be more than sufficient to keep the basics of your financial affairs in order. Many companies specialize in the concept of outsourced bookkeeping, where they provide the services to you on a predefined schedule, and you pay an hourly or fixed monthly fee. This may be the best of all situations for you—the outsourced bookkeeping service does what it does best, and you do what you do the best (marketing, production, etc.), without a direct hit to your payroll.

It's also important to complement these bookkeeping services with the use of a part-time controller or CFO (Chief Financial Officer). Someone with this level of financial expertise can help you understand the big picture—a crucial element to your success.

For example, your bookkeeper can report to you the balance of your checking account. A part-time controller can help you identify whether your business is going to be in a cash crunch in forty-five days and figure out how to solve the problem. Having someone with these skills to assist you as few as four hours a month can be a very profitable investment.

Getting a solid foundation under your books is critical to the success of your business. The use of outsourced bookkeeping firms and a part-time controller/CFO can offer enormous benefits.

Scott Gregory

Solutions

Get an experienced bookkeeper on your team. Consider part-time and outsourced bookkeeping firms for their expertise.

Hire a part-time controller/CFO to help you understand the story behind the numbers.

Your Bookkeeping Stinks—Stinker #2

My staff has free time—I'll let them handle the payroll.

Friend, this situation is very likely a disaster waiting to happen. The only question that will need to be asked is how large of a check you'll be writing in order to satisfy the tax agent.

The world of payroll is fraught with constantly changing rules and regulations. Unless you are going to train and prepare your staff to stay on top of these, errors and omissions are likely to occur. These errors and omissions can be costly.

I typically hear this argument: "How hard can it be? I just have a handful of employees to pay every other week." At the most basic level, the actual preparation of the paycheck is, in fact, pretty easy. But the complications immediately follow: making sure that all the payroll taxes are deposited on a timely basis and that payroll tax returns are filed with the appropriate agencies. One little mistake in either depositing or filing on time can result in a letter suggesting that you owe taxes, not to mention penalties and interest, too! And these penalties and interest are usually not waived. Believe me when I say that tax agencies don't readily accept the "I didn't know about that" response.

A recent *Wall Street Journal* article cited the following statistics involved in handling payroll:

Selected Payroll Tax Statistics, 2005

Estimated number of employer tax updates in 2005	400
Average annual penalty on employment tax returns	\$670
Estimated time to fill out a quarterly payroll report for the IRS	13 hours
Approximate cost of using a payroll company	\$50 per pay period (10 employees on a biweekly payroll basis) ¹

¹ *The Wall Street Journal Small Business Report*, January 30, 2006.

Scott Gregory

Just like the basic bookkeeping tasks mentioned earlier, your business can reap great rewards by outsourcing your payroll processing, tax deposits, and filings. More importantly, you can *avoid* the many problems and potential penalties that business owners encounter when they try to navigate the maze of tax regulations themselves.

A wide variety of companies provide outsourced payroll services. You may be familiar with ADP, Paychex, and QuickBooks. You can find others simply by entering “payroll services” into your favorite search engine.

Think about it another way. If you took the total time that your payroll processing requires over the course of a year and devoted that same amount of time to customer service or sales and marketing activities, it would more than pay for the cost of having a third party process your payroll. Guaranteed.

Solution

Unless you have a payroll expert on staff, outsource the preparation of your payroll, tax deposits, and tax filings. Redirect the time your staff currently spends on payroll tasks to more value-added activities in customer service and sales/marketing.

Your Bookkeeping Stinks—Stinker #3

My do-it-yourself bookkeeping software generates bad reports and information.

Let me be the first to say that current versions of small business bookkeeping software such as QuickBooks and Peachtree are absolutely wonderful tools. The features and functionality they contain for the modest prices charged provide a truly remarkable suite of tools and reports to use in managing your business.

Unfortunately, many small business owners rush out to their local big-box retail store, make the purchase, install the CD, and think they are magically turned into bookkeepers. In reality, it simply doesn't work that way.

In my QuickBooks consulting practice, I have come across many small business owners' automated sets of books that have been unmitigated disasters. In the quest to save a few dollars, the business owner has decided to set up his or her bookkeeping system while flying solo. This is usually a big mistake. The automation just gets them bad information faster.

While the system may seem to work fine for a couple of months or even a year, the game is up when business owners hand their accountants their first set of reports to use in preparing their income taxes. In many cases, the accountant's initial response is, "What is this #\$\$%*?"

Then reality sets in, as the accountant has to do double or even triple the amount of work to make things right. In some cases, the accountant even recommends taking a stick of dynamite to the records and starting over, as they are simply too bad to work with. I don't know about you, but I prefer *not* to pay my accountant double for anything. Paying triple is out of the question!

Your accounting software can only provide quality feedback and reports if the underlying data is accurate and timely. Thinking about the problem areas we've reviewed already, you may have bad data funneling in from someone not skilled in bookkeeping, or you may have bad payroll data being created by someone not skilled in payroll. Or you may have taken some shortcuts in the early days and made some bad decisions in setting up the books. And we're just getting started. Ready for some heartburn medication?

In order to optimize the use of accounting software, you'll want to invest in professional help to get it installed and set up properly. Over 25,000 QuickBooks advisors across the country are available to assist with the setup of their software. Other packages offer professional support as well. Ensure that you coordinate the setup of your accounting system with your tax accountant, too. He or she will be

Scott Gregory

working with the results and may have some specific thoughts on setup issues to help keep things streamlined.

Solutions

Get professional assistance when setting up your accounting software—the dividends will be enormous during the life of your business. If it's already been set up, then get a tune-up to ensure it's been done correctly.

Don't let your IT person set up your accounting software system just because he or she "knows computers."

Your Bookkeeping Stinks—Stinker #4

Your chart of accounts has more than fifty accounts listed.

The chart of accounts you have created is the heart and soul of your accounting system. Think of it as a filing cabinet for your business transactions. One drawer in the cabinet contains information about your business assets, another drawer keeps information about your revenue, and yet another holds details about your expenses. Each account in each drawer is stored in its own manila folder.

How many manila folders do you have in your chart of accounts? Is it more than fifty? Unless your business is fairly large or extremely specialized, over fifty is too many.

Accounting software used to be set up in a way that was difficult, if not impossible, to easily get the details behind the balance of an account. Because of these earlier limitations, businesses set up accounts and sub-accounts for just about everything you could imagine, whether they used them or not. The result of this decision was an extensive and very confusing chart of accounts.

Using the “drill down” capability available in modern accounting software, it’s easier than ever to get the story behind the numbers. For example, if you were looking at the utilities expense line on your profit-and-loss statement (P and L), you could easily “explode” the number to see all of the transactions that were included in it. Because of this, it’s no longer necessary to have a long and complex chart of accounts.

A shorter chart of accounts also helps your staff be a lot more consistent when recording individual transactions. Just like having timely data entry, consistency is another key to ensuring your bookkeeping is the best it can be.

True Story

While working with a client that had revenue of about \$2 million per year, I discovered that her chart of accounts contained over 160 different accounts! This was about 110 more than she really needed for an efficient, effective accounting system. The end result was that she had many balances of less than \$100 showing on her annual financial statements.

Scott Gregory

Solution

Work with your accountant to determine ways to reduce the number of accounts listed in your chart of accounts for greater ease of use and accuracy in recording accounting transactions.

Your Bookkeeping Stinks—Stinker #5

I don't have to reconcile my bank accounts, do I?

Do you keep track of the balance in your business checking account by the “I think this is our balance” method? Do you even keep track of the ins and outs of your account?

Now more than ever, it's critical to go through the process of comparing your checkbook balance to what appears on your bank statement on a monthly basis. The word “reconcile” is nothing more than accounting-speak for comparing your books to the bank statement and making sure they are in sync.

The reconciliation process ensures that you've entered all your transactions into your bookkeeping software and not overlooked any of them. In addition, it helps provide you the confidence you need to plan the release of the outgoing checks to your vendors without the fear of them bouncing.

In today's business world, there are a variety of ways to take funds out of your checking account other than the traditional check method. Debit cards, ATMs, wire transfers, and others exist to help make your life more convenient. With this convenience, however, comes the possibility that you will overlook recording one of these withdrawals. Failure to do so can have significant consequences for you when the bank starts laying down insufficient funds charges of \$30 or more per check!

Another critical benefit of reconciling is ensuring that no monkey business is going on with your business funds. In a small office environment, one person typically does many things. This person may create the checks, sign the checks, and reconcile the bank account. If, however, this person is even a little less than honest, the temptation is there to create checks and payments that aren't legitimate. His or her thinking is, “Who will catch me? I'll be able to cover my tracks with no problem.”

This is where the concept of segregation of duties comes into focus. In order to have optimum control over your bank account, you'll want the person who signs the checks to be different from the one who reconciles the bank account. Even if there are just two people in your office, one should write the checks, and the other should reconcile the account. At the very least, you should double-check the work of the person who reconciles. Countless stories of fraud and embezzlement have been reported where a person in a position of trust (think: your bookkeeper) stole from his or her employer over a period of time.

Scott Gregory

Solutions

Compare your bank statement to your bookkeeping software balance (reconcile) on a monthly basis, and resolve any discrepancies as soon as possible.

Ensure that there is a segregation of duties within the office. Don't let the same person write the checks, sign the checks, and reconcile the bank account. You may be sorry if you do.

Your Bookkeeping Stinks—Stinker #6

What is a profit-and-loss statement? I've never created one.

The most common question I hear from business owners is, “How is my business doing?” Day after day, these owners wish they had some insight into their business finances to know their levels of income and expenses, as well as other measurements of success or failure. They know that checks have been written and deposits made, but they aren't really sure of their overall impact.

The profit-and-loss statement, also referred to as an income statement or a P and L, is a standard accounting report that keeps track of the amount of income your business has generated and the amount of expenses you've incurred over a certain period of time (*i.e.*, a month, a quarter, or a year). Your bookkeeping software should be able to generate this report and many others with just a few clicks of the mouse.

As you are digesting the valuable information in this report, it is important to understand a couple of nuggets of accounting-speak: cash basis and accrual basis. Very simply, a cash basis P and L provides a recap of when your deposits went into the bank (income) and when your checks were written (expenses). An accrual basis P and L provides the same recap, but your income figures are based on when you sent out the invoice (regardless of the date it was paid) and the date the expense was incurred (regardless of the date the check was actually written). Don't let the differences between these reports cause you a lot of sleepless nights—both of them can be helpful to you.

The P and L will become one of your top three financial reports used regularly to gauge the health and welfare of your business. (The other two are your accounts-receivable aging report and your sales-by-customer summary.) In many cases, it is extremely helpful to create a profit-and-loss report and compare one period to another.

For example, I could create a report that showed my income and expenses for the current quarter, and then compare these results to the same quarter a year ago. I would be able to instantly see where my results were better this quarter, and where they needed some improvement.

Scott Gregory

Solutions

Create a P and L for your business each and every month. Compare the results of the current period with the same period last year to isolate areas that need improvement and/or to highlight areas of success.

If you are not sure how to interpret the information on the P and L, then enlist the services of a part-time controller or accountant skilled in managerial accounting. These professionals are worth every penny, as they can help you identify problem areas and suggest steps for improving your results.

Your Bookkeeping Stinks—Stinker #7

I've got inventory. I have no inventory control.

Inventory control is one of the biggest sources of pain and frustration for many small business owners today. Keeping track of what you have on the shelf, what is on order, how much it costs, and other bookkeeping nightmares haunt business owners everywhere. Not knowing how much inventory you have creates a host of problems in your business operations, including:

- Stock-out situations on customer orders
- Not getting new stock ordered on a timely basis
- Not being able to calculate a total value on your inventory for your financial statements
- Putting in place workarounds and other processes where they may not be needed

Sorry to say, but there is no magic solution to tracking your inventory. It is critical however, that you develop a system to do just that, even if the system has some inherent problems with it.

Most inventory-control systems used today have issues of some sort with them. Keep in mind that these issues may not have anything to do with improper operation of the inventory software. In many cases, the issues are the result of policies and procedures that are not getting the job done properly.

Most bookkeeping software does an adequate job of enabling you to track the quantity and flow of inventory through many types of businesses, especially if you are selling finished goods or other products that consist of one or two components. But if your business has a multi-step process for converting raw materials and labor into a finished product, then you will want to consider adding a more robust inventory and “shop floor” software package to your operations.

The benefits of proper inventory tracking are simply enormous for small businesses. When done correctly, you'll be able to instantly tell callers whether something is in stock (and avoid a trip to the warehouse).

You'll also be able to keep this critical piece of data up to date on your balance sheet. If your business has a bank loan, many times the bank will loan you a certain percentage of the value of your inventory. Given this, your loan officer will want to know the value of your inventory on a regular basis.

Scott Gregory

Solutions

Tackle the tracking and reporting of your inventory with some type of system, whether manual or automated. You will reap the rewards from the time and effort required to implement such a system.

If you agree that the need is there but feel over your head in the world of inventory control, then enlist the help of an inventory consultant or accountant who can help you put a successful system in place.

Your Bookkeeping Stinks—Stinker #8

It's OK to mix personal and business expenses, right?

Don't let the IRS hear you ask that question!

Let's just say this—it is essential that you track your business and personal expenses separately, especially if some of your personal expenses come out of the business checking account.

This is a common issue that gets many business owners into hot water with the IRS. By accurately tracking these transactions, you'll be able to offer much more concrete proof of what is actually going on.

Example #1

You incur various meal and entertainment expenses over the course of a month on behalf of the business. Currently, you write yourself a check for \$500 a month, as you “think that's close to the amount you spend at various restaurants.”

A Better Approach

Create an expense report each month that lists the individual expenses, and attach the receipts for them. Submit the expense report, and then have the business write you a reimbursement check for the total. This way, all of the expenses are documented and recorded. IRS auditors love that. In addition, this approach eliminates checks being issued to you for estimated amounts with no supporting documentation.

Example #2

You take a cash advance on your personal credit card to carry the business through a cash-flow crunch and deposit these funds into your business checking account. When you do this, you show the cash going into your checking account, but you don't have a clue where to record the rest of the bookkeeping entry.

A Better Approach

If you must take a cash advance on a personal credit card, it is best to treat this transaction as a loan between you and the business. Record the amount of the advance in your checking account as you usually do, and at the same time, create what is known as a “loan payable” to you. As the business pays you back over time, the loan-payable balance will decrease and ultimately go to a zero balance, once the loan has been paid in full. Be sure to check with your accountant to

determine whether you need to figure interest on this loan to keep you in compliance with tax rules and regulations.

Example 3

Your business issues a check each month to cover your car payment. But the car is titled to you personally and is not recorded as a business asset. As it is, this is not truly a tax-deductible expense, since the payment is not going toward a business asset.

A Better Approach

Situations like these can be tricky, as there are a number of factors to consider when choosing the best approach. Make sure to review the details of these types of transactions with your tax accountant. He or she will be able to help you optimize their potential tax deductibility.

It's easy to be tempted to mix personal and business expenses. But this has been and will continue to be a major source of concern to the IRS. The rule of thumb to keep business and personal expenses separate is just as good today as it has always been.

Solutions

Consider creating an account in your chart of accounts called "Ask My CPA" for personal transactions that are being paid by the business. This will enable him or her to understand the nature of the payments and provide you the guidance needed to keep them properly recorded in your books.

Make sure to keep detailed records of loans and cash advances that you make to the business.

Your Bookkeeping Stinks—Stinker #9

My estimating process is a disaster, and I can't create invoices from estimates easily.

Have you explored the options in your bookkeeping software to create an estimate within it, rather than having to sit down with your word-processing software to create one? If you haven't investigated this timesaver, do so now.

For example, in QuickBooks software, the functionality to create an estimate is built right in. You have the ability to customize the different fields and columns that your estimate will contain, and then launch the estimate directly into an e-mail or print it out for faxing or mailing to your customers.

The software keeps track of all the open estimates you have created, which will help keep you focused on the potential orders and projects you have quoted. You can even tie these estimates into a built-in reminder system that tells you when to contact your customers or prospects and follow up on the estimate.

Best of all, once you get the job and have completed the work on it, QuickBooks will let you convert the original estimate (or the revised estimate, where necessary) into an invoice with just one click. Why stop and retype or rewrite your invoices, when your bookkeeping software can convert your estimates for you automatically?

Even if you are only billing your customer for a few of many lines of an estimate or for a progress billing on it (*e.g.*, 33 percent of the balance), QuickBooks gives you the option to handle these progress billings with ease. You always have the choice to bill for the entire job, for a partial amount, or for certain line items within the estimate.

In many small businesses, the estimating-and-quoting process becomes a huge black hole—nobody seems to know where the estimates go once they have been created, and they certainly don't know how well they are converting the quotes into actual orders. Don't let your business fall victim to this process. Bring some order to it, and increase the effectiveness of the time you spend generating estimates.

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Solutions

Investigate the estimating capabilities of your current bookkeeping software, and reap the benefits of automating the process as much as possible.

If your business requires more sophisticated estimating than is available, consider a separate estimating package that automatically feeds the data into your bookkeeping software.

Your Bookkeeping Stinks—Stinker #10

What is accounts-receivable management? I have no idea what you're talking about.

At the last small business seminar you attended, the speaker lectured on the importance of managing your accounts receivable better. Unfortunately, you had no idea what he was talking about.

Accounts-receivable management is the critical process by which you keep track of the sales you have made to your customers on a “pay me later” basis. An example to help explain: if you sold your widgets to me over the counter and I paid you with a credit card at that time, this is referred to as a “cash sale.” If, however, you sold me those same widgets and gave me terms of “net 30 days,” you would have sold them to me on a credit, or “pay me later,” basis. In accounting-speak, you have created an “account receivable.”

I can't emphasize enough how critical it is to track and monitor each and every credit sale you make. Every dollar you have tied up in credit sales is a dollar that you can't use elsewhere in your business. Every customer balance that extends beyond the terms you have granted costs you money!

To simplify the administration of your credit sales and accounts receivable, you will want to generate an accounts-receivable aging report on a regular basis. This report will tell you the following vital information: who owes you, how much they owe you, and how long they have owed you. The aging report makes it very easy to spot those customers who have slipped beyond their credit terms, as it puts everything in neat little columns, such as Current, 1-30 Days, 31-60 Days, and so on.

Administrating your accounts receivable will be a critical factor to the success or failure of your business. It is essential that you dedicate the time and resources necessary to this area to ensure that you keep current with problem customers and issues.

For maximum effectiveness, you will want to develop what is known as a credit-and-collection policy for your business. This type of policy covers such questions as: To whom and how do we grant credit? How do we handle customers with overdue balances? Do we charge finance or service charges? A credit-and-collection policy helps eliminate a great deal of the guesswork found in too many small businesses today. It puts in place an organized set of ground rules for you to follow when dealing with the customers you sell to on a credit basis.

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Solutions

Run an accounts-receivable aging report on a regular basis to spot problem accounts quickly, and take corrective action on overdue balances.

Develop and implement a credit-and-collection policy to streamline and bring consistency to the way you handle your credit customers.

Your Bookkeeping Stinks—Stinker #11

I'm in a cash-flow crunch right now. Help!

It's easy to think of the concept of cash flow and get a migraine at the same time. The good news is that you don't have to reach for the aspirin just yet.

Your cash flow is the lifeblood of your business. Without it, you simply don't survive very long. Because of this, it is extremely important to keep an eye on your projected cash receipts and expenses. This will allow you to pinpoint potential cash-shortage situations much earlier and have plans in place to deal with them, thereby avoiding having to throw a last-minute plan together to deal with a crisis. Bad and costly decisions are frequently made when the pressure is on.

Simply stated, cash-flow management is the process of tracking the cash coming into your business and the cash going out of your business. In many cases, the cash coming into your business comes from credit customers paying off their account balances and your cash sales being deposited into the bank. The cash leaving your business is typically in one of these major categories: payroll/wages/taxes, materials and supplies, sales and marketing expenses, and general/overhead expenses.

Naturally, the goal is to ensure your incoming cash is greater than your outgoing cash. The unfortunate reality is that it doesn't always happen this way, and you encounter a period where things are a bit tight.

The development of a cash-flow projection helps you identify future tight spots. It then forces you to develop a plan for dealing with them. Will you be taking a cash advance on your credit card to keep your bills paid? Will you borrow from your bank to cover this shortage? Or will you simply defer payment to your vendors until they call and scream that your account is overdue? There are advantages and disadvantages to each of these strategies, and it is a judgment call as to which one is best for you—though constantly stretching out your vendors will typically get you converted to COD status sooner than you think.

A basic cash-flow projection can be pieced together on a ledger pad. List your projected incoming cash and the main cash expense categories you'll have over the next two months. You'll quickly see where the problem areas are. As you get more comfortable with the basics of cash-flow planning, you can move on to some of the automated tools that may be included in your bookkeeping software.

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Solution

Cash flow is what keeps a business alive. Take the time to create a cash-flow projection for your business that focuses on your estimated cash in and out for the next two months. This information can be compiled on a simple ledger pad or a spreadsheet to help keep it simple yet effective.

Your Bookkeeping Stinks—Stinker #12

F-F-F-Fraud?! It couldn't happen to me—could it?

Your business doesn't have to be the size of Enron or MCI to be subjected to the very serious and potentially catastrophic problem of fraud.

Examples

- The bookkeeper for a small business was convicted of embezzling over \$40,000. She had been the bookkeeper there for over ten years.
- The dentist's accountant who never deposited the dentist's payroll taxes, even though he was paying taxes to the accountant on time.

As the owner of a small business, it is easy to get distracted by all the other issues that surface on a daily basis. Bookkeeping isn't something that typically gets the amount of attention it needs if there are customers who aren't getting their orders on time due to a shipping snafu.

It's imperative that you take the time to assess your current bookkeeping arrangement to ensure that you've taken reasonable precautions to thwart the problem of fraud. Notice I said "reasonable precautions" here. You can't design a system that is completely foolproof, as evidenced by the high-profile fraud cases in the news during the last few years.

Remember, in many cases, it is a trusted and valuable employee who steps over the line and embezzles funds or commits other acts of fraud against the employer. Some rather simple steps go a long way toward battling fraud in your business.

Scott Gregory

Solutions

Segregate duties wherever possible. Don't let the same person who creates the checks sign them. Don't let the same person who orders your goods and services issue the checks for them.

Run some random spot checks on your bookkeeping system to verify that deposits are being made properly and that issued checks have supporting documentation.

Enlist a part-time controller or CFO to perform periodic reviews of your bookkeeping department to help identify any problems and/or make suggestions for improving the department's efficiency.

Your Bookkeeping Stinks—Stinker #13

You mean I should keep track of my fixed assets?

Nothing will make your eyes glaze over faster than a discussion of the word “depreciation.” But if you heard the words “tax savings,” you’d sit up and take notice. It’s really funny then, how so many small businesses lose precious tax savings by not keeping better track of their fixed assets and their related depreciation.

Take a quick look at your most recent balance sheet (the balance sheet is the one that lists what you own and what you owe). Do you see one category called “fixed assets,” or do you see things like “computer equipment,” “furniture and fixtures,” or “machinery and equipment”? Different classes of fixed assets have different IRS tax rules that apply to them. If you lump everything together under one fixed-asset account, then you’re likely not maximizing your tax savings.

Don’t worry, I’m not asking you to keep track of the depreciation calculations for all of your fixed assets. That job is definitely best left to your tax accountant, since the rules are constantly changing. Your accountant, however, will probably give you a big hug—and possibly knock a few dollars off your bill—if you help him or her by keeping better track of the fixed assets your business owns and acquires in the future.

Better fixed-asset records enable your accountant to classify items more accurately, and they reduce the amount of guesswork involved when he or she is working on your tax return. As a result, your accountant will be able to optimize the tax benefits available to you as they apply to the multitude of fixed-asset classifications under the current tax laws.

When talking about fixed assets, you will likely encounter the concept of “capitalization criteria.” Don’t let this accounting-speak throw you—it is simply a way of saying, “At what dollar amount will the business record a purchase as a fixed asset, and when will the business record it as an expense?”

For example, let’s say your tax accountant has determined that your capitalization criteria is \$1,000 in terms of recording the transaction in your books. (Let your accountant handle how it is recorded on your tax return.) If you went out and purchased a new computer for \$1,500, then that purchase would be above your “capitalization criteria” of \$1,000. Therefore, it would be recorded as a fixed asset in your books. If this same computer cost \$800, then it would be less than the \$1,000 threshold and would be recorded as a “computer expense” in your books.

Scott Gregory

Solutions

Talk to your tax accountant about the benefit of keeping better records of your fixed-asset purchases. Ask him or her how doing this might lower your accounting fees. (Hey, it can't hurt to ask!)

Set up your books with the proper fixed-asset categories, and not just one catchall account for all of your fixed assets.

Your Bookkeeping Stinks—Stinker #14

The last time I backed up my accounting data was six months ago.

Bad things happen to good computers. Why else would the tech-support lines of Dell and HP be busy 24/7?

This is why it is *critical* that you develop and implement a solid, reliable plan to back up your accounting data (and other important business files as well). Think of it this way: you can always go to the store and buy another copy of your Peachtree or QuickBooks software, but you can't pick up a copy of your accounting data while you're there.

Ideally, you will want to back up your accounting data each and every day that you make changes to it. The best backup plan will be simple to implement, as automated as possible, and will create an offsite copy of your data. If it's a pain in the you-know-where to do the backup, then chances are high that it won't get done.

If your computer has a significant problem (*e.g.*, hard-drive failure, virus invasion, etc.), there is no "do over" button you can push to make it go away. By then it is simply too late to try and recover your data. Since you don't know when a technology snafu will land in your office (but figure it will be at the worst possible time), you'll want to be proactive in your backup planning and execution.

To ensure your backup plan is simple, automated, and offsite, my suggestion is to enlist the services of an online data-backup provider. One of my favorites is Backup My Business, and you can take a free test drive of the service at <http://btl.backupmybusiness.com>. Or you can type "online data backup" into your favorite search engine and find links to other quality providers of these services.

If you prefer to handle your own backups, then by all means do *not* back up your data to floppy disks. Use more reliable media like CDs or DVDs. The key thing to remember if you are following this approach is to ensure you take a copy of the CD or DVD to an offsite location on a regular basis. Going through the process of creating backup discs and leaving them onsite will not do you any good in the event your office or facilities are destroyed by a natural disaster.

Scott Gregory

Solutions

Your backup plan must be easy, automated, and offsite to ensure it is done on a regular basis. Don't leave this crucial piece of business planning to chance, or you will run the risk of a complete disaster in the loss of your critical financial records.

Evaluate the benefits of online data backup services to simplify the process.

Your Bookkeeping Stinks—Stinker #15

My staff still scribbles purchase orders by hand.

Manual purchasing systems are another of the great time-killers in small business today.

I've seen many businesses that still rely on a purchase-order book that is manually updated with each and every purchase order created. Even worse, I've seen many businesses that don't have *any* type of system in place to track the materials, supplies, and other goods that are ordered for the business.

The potential damage to your bottom line from not having a purchase-order system in place can be significant. In other words, who is controlling and overseeing how much you purchase and the prices you pay for these goods?

A purchase-order system doesn't have to be complicated to be effective. Your main goal with a system like this is to ensure that you are spending company money only on things that are needed for the business *and* that you are getting the best price for them. A purchase-order system enables you to view the history of your purchases from specific vendors, and it adds control to your buying process.

Purchase-order functionality is common in many small business bookkeeping programs today. By having it built into the software you use every day, you will be able to generate a new purchase order with just a few clicks and even e-mail that purchase order to your vendor. You will also be able to pull up a list of any and all open purchase orders with no effort, so you can track the status of them. As purchase orders are opened and closed, you will then begin to build up a vendor history that can be invaluable to you if you need to order from a particular vendor again. Finally, many bookkeeping programs will permit you to generate a check to pay your vendor as a direct result of receiving the goods you ordered via a purchase order.

Again, it is important to emphasize that a purchase-order system doesn't have to be complicated to be effective. Once you take the time to put one in place, you will quickly see how it can bring some order and control to an area that is frequently disorderly and out of control in many small businesses.

Scott Gregory

Solutions

Assess the current level of knowledge and control in your purchasing system. Is it effective? Chances are, it can be greatly improved without a tremendous amount of effort.

Ask your staff to help you identify problem areas in your current system and to help you design your “new and improved” purchasing system.

Your Bookkeeping Stinks—Stinker #16

I owe the bank how much?

Can you tell by printing a copy of your balance sheet how much you owe your bank? Chances are, you probably can't.

Similar to the concept of managing the things you own—like your inventory and fixed assets—it is essential to manage the things you owe as well. Your bank loans fit into this category very nicely.

The common problem that occurs when tracking loans is not having an understanding of how to record payments in your books. Remember, the bank loan is considered a business liability (something you owe). Because of this classification, it shows up in the liability section of the balance sheet.

For many businesses, however, it becomes habit to create an expense account called “bank loan payments.” This account is then used to record each of the monthly payments made on the loan.

Unfortunately, this process is incorrect, and it inflates the business expenses for the year. Depending on the size of the loan payments, this approach could have a potentially significant impact on your business's financial reports.

In most cases, a loan payment made to a bank consists of both a principal and interest portion. The correct way to record the monthly payment requires two distinct components: a reduction of the loan balance (you are reducing the amount of your liability account) and an increase in the interest expense account. The total of both the principal and interest amounts is the amount that is deducted from your business checkbook. Under this plan, however, only the interest portion of the payment shows up as an expense on your profit-and-loss report.

When discussing bank loans, you may have heard the term “amortization table.” This is simply banking-speak for a chart that breaks down the amount of interest and principal for each payment you make. Your loan officer can provide you with one of these amortization tables to help ensure the loan payments you record in your books are properly broken down between the principal and interest components.

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Solutions

It's essential to ensure that bank loan payments are recorded correctly so they do not accidentally overstate the amount of expenses incurred by the business during the year. Obtain an amortization table from your loan officer. (Your accountant can create one for you as well.)

Proper recording of each loan payment will ensure that your books accurately reflect the balance of your bank loans. This is an important piece of your overall financial management.

Your Bookkeeping Stinks—Stinker #17

The black hole of business credit cards

Frequent-flyer miles, rewards, and bonus points have lured many small businesses into using credit cards to purchase goods and services. Conceptually, this is a terrific idea, as it consolidates your purchasing into a very manageable system, and the business reaps the rewards.

Unfortunately, many small businesses don't account for their credit card purchases correctly, and this can cause a rather large headache for their accountants to sort out at tax time. What I commonly see is an account called "Credit Card Expense," or something similar, and this is where things start to go wrong.

To handle credit card transactions properly and improve the accuracy of your books, each of the line items that appears on the statement should be recorded separately. If the first line is for a purchase from a gas station, then that charge should be recorded in your automobile expense account. If the next line is for a purchase from a local office-supply store, then that charge should be recorded in your office-supplies expense account. If a line on your statement is a charge from a local restaurant, then that charge should be recorded to a meals-and-entertainment expense account, and so on.

If you are not currently handling the bookkeeping for your credit cards this way, it is not too late to change. Take a closer look at your software to see if it has some built-in tools for simplifying the recording of your credit card transactions. QuickBooks, for example, has a specific screen that is used to ensure that these transactions are handled properly.

You will also want to reconcile your credit card statements with the same diligence that you use to reconcile your bank account (as mentioned previously). By digging into the details of your statement and comparing it to your financial records, any duplicate or suspicious charges can be identified and corrective action taken. If you simply pay the credit card bill after a quick review, you are missing out on the opportunity to ensure it is correct, and you may end up paying for charges that are simply not yours.

By recording your credit card transactions correctly, you will be able to quickly see how much you owe your credit card company. When the time comes to pay the statement, you simply reduce the amount in your bank account by the amount of the payment, and you also reduce the amount of your "credit card liability" account by the same amount. While this concept may seem a bit confusing to you right now, once you go through the process a couple of times, it

Scott Gregory

will make perfect sense. Even better, you will have a much more accurate accounting of all of your business credit card transactions, and your tax accountant may just hug you one more time!

Solutions

Even though credit cards are extremely popular and convenient ways for small businesses to make purchases, tracking these expenses is commonly done incorrectly. Ensure that you record each line item that appears on the credit card statement as its own expense account. Don't use an account called "Credit Card Expense," as this will create confusion for your tax accountant.

Consider the idea of an electronic download of your credit card transactions into your bookkeeping software. It can simplify the process even more.

Your Bookkeeping Stinks—Stinker #18

Did I make any money on that job?

If your business is job- or project-based, do you have any idea if these jobs are actually profitable? Chances are good that you haven't been tracking this type of information in your accounting system. Chances are even better that your customer jobs aren't as profitable as you think.

The process of recording your income and expenses for a particular job is known as job costing. The main advantage of using job costing in a business is the ability to run a report that shows whether a specific job made or lost money, as well as the detailed costs of the job.

To take the concept of job costing even further, you can compare the estimated income and expenses of a job to the actual income and expenses. This information allows you to understand where the job performed better than expected and where it ran into problems, compared to how you envisioned it when you prepared the job estimate. From there, you can use this experience and knowledge to fine-tune your estimating process in the future, with the goal of making your jobs more profitable.

Job costing does not have to be a complicated process. In fact, many small business accounting software packages today offer a built-in job-costing module. As you use the software to record the materials, payroll expenses, and other costs, you attach them to a particular job or jobs that are underway. This process is repeated as additional checks are written or invoices are created.

Once all of the accounting for a job is complete, the software provides the ability to run various reports, such as a job-profitability detail, a job-estimate-versus-actual summary, and a list of costs by job. In addition, for jobs of longer duration, you are able to get a snapshot at any point in time of your costs and identify problem areas much sooner than if you simply posted your accounting information when the job was done.

In order to optimize the use of job costing in your business, it is critical to understand how the job-costing module in your accounting software works. Take the time, and make the investment necessary to get your bookkeeper trained. The minimal costs you incur for this will be recovered quickly by having the ability to monitor your profits and losses at the job level. Without this information, you are at risk of pricing your jobs too low and losing money on them.

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Solutions

Explore and learn the job-costing functionality of your accounting software to enable income and expense tracking by job or project. If your current accounting software does not provide this capability, investigate alternative solutions.

Become proactive in managing your jobs and projects with job-costing information. Identify cost overruns much sooner, compared to original estimates, and enable your job-estimating process to become more profitable as a result of having better cost and revenue information available.

Your Bookkeeping Stinks—Stinker #19

My bank needs my financial statements. I'm in trouble now!

You've maxed out your credit cards, and you can no longer finance your business by taking cash advances against them. The time has come to get a bank loan to help keep your business's products and services flowing. Are you ready for a visit to the bank?

If you have been keeping your books using the shoebox method, it is safe to say that you will not win any points when you sit down to discuss your business loan. In fact, having your records in such disarray will work against you during the loan process.

The loan-origination process (as banks like to refer to it) requires a review of the various financial statements of your business. Typically, this includes your profit-and-loss statement, your balance sheet, and your budgets for a one- to three-year period. If you are not able to generate these statements in your current accounting system, you will have to pay your outside accountant dearly to create them for you.

But you say you have the tax returns for the business—aren't they enough? The answer is simply, no. Your tax returns will certainly be helpful during the loan-origination process, but they must be supplemented by the other statements, too. Bankers need to see your statements prepared in what is known as generally accepted accounting principles (GAAP). These principles ensure that your financial information is presented according to standardized methods and procedures (and not the creative bookkeeping you may employ from time to time).

In many cases, the absence of solid business financial planning creates an urgent need for a bank loan. If your records are in disarray, this process will slow to a crawl until you are able to prepare and present professional financial statements. Even worse, if you have your outside accountant prepare all of this information, you will be at a significant disadvantage when talking with the bank about your loan.

The loan-origination process can be extremely detailed, and questions about your business finances will often arise. While it is acceptable not to know the answer to all the questions that may be posed, you will again be at a distinct disadvantage if you answer each question with "Let me check with my accountant on that and get back to you." It tells the loan officer that you are not in tune with the operations of your business—the last thing you need when you have a loan application underway!

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Solutions

Put in place an accounting system that will allow for easy creation of your business's important financial statements and records. Many software packages can provide commonly used business financial statements with just a few clicks of the mouse.

Ensure that the information that does appear on your financial statements is accurate! If your income is overstated or your expenses understated due to flaws in your processing of accounting data, then there is danger ahead. If you are unsure of whether your accounting system is working properly, then enlist the help of an accountant who is well versed in properly setting up accounting systems and who understands the issues of management accounting. This person will likely *not* be your current tax preparer.

Your Bookkeeping Stinks—Stinker #20

I give my accountant a shoebox or file folders crammed with receipts at the end of the year to prepare my business taxes.

Everybody loses in this situation. You lose. Your tax accountant loses, too.

When using the shoebox method, you lose for several reasons. The first is that your accountant has to make educated guesses about the nature of various documents you have given him or her. Because of this, you may lose out on valuable tax deductions or benefits, simply because your accountant may not understand the nature of the transaction.

In addition, you lose because it takes your accountant extra time to sort through the mess in order to get to a working understanding of what information you have provided and what may be needed but missing. Since accountants get paid by the hour in most cases, you are assured of paying more than you need to for their services when you hand them a shoebox.

Compare this to a preferred alternative: handing your accountant a set of financial reports for the business or, even better, handing over a disc with all of your accounting records on it. In these scenarios, your accountant starts out with much better information from which to make decisions and prepare your taxes. For the same amount of money you were spending before to sort things out, by using accounting software, your accountant can also provide you with some tax planning and additional insight into your tax situation.

Accountants lose in the shoebox game as well. In fact, they dread this type of situation. They would prefer to spend their time and expertise helping clients maximize their tax deductions and minimize their tax bills, rather than digging through stacks of paid bills and other documents trying to figure out what happened.

Frankly, there is *no* good reason not to be keeping your financial records in a computerized accounting system. Entry-level programs start at less than \$100, and, in many cases, these programs will be all your small business needs. If you aren't willing to invest that much in your business, then you may actually just have a hobby that is pretending to be a business.

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Solutions

Make a commitment that this will be your last year without a computerized accounting system in your business. The advantages to having one will be tremendous, and your accountant will love the idea, too!

Allow plenty of time to get your accounting system set up. Too often, the setup process is rushed, and because of this, costly errors and mistakes are made. Figure thirty to sixty days of lead-time to set things up correctly.

Your Bookkeeping Stinks—Stinker #21

I just purchased some accounting software. I should be able to set it up myself, right?

This is a recipe for disaster.

If there is any time in the life of your business to invest in its future, now is it! Many of the setup decisions made with new accounting software will be critical to ensuring that it provides correct information each month and is being used to its full potential to meet the needs of your business.

When reaching out for assistance to get your software set up correctly, don't automatically assume that your accountant is the best choice, since he or she "knows accounting." He or she may *not* know your accounting software!

Consultants are available for just about every accounting software package on the market. Ask for references from friends, or search the Internet for resources. Your investment in these services will pale in comparison to the fees you will have to pay later, once you discover that your software is not set up correctly and costly changes will have to be made in order to fix the problems.

In addition, local resources can train you to properly operate the software, and they can introduce you to features and functionality that will really help streamline the accounting process each day. This is especially true when you get into areas beyond writing checks and creating invoices, such as purchasing and inventory control, creating and customizing reports, and budgeting.

If your business is moving from an existing accounting program to a new one, then hiring a consultant is also a wise investment. There are many potential issues and problems that can occur when switching software packages, and it is critical to have a well thought-out plan in place to ease the pain of the transition—and there will be some pain! A consultant can help you identify the problems that are unique to the way you do business and map out a plan that will streamline the transition process as much as possible.

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Solutions

Don't be cheap. Make the investment required to get your new accounting software set up and configured properly for your business. Shortcuts and mistakes made by taking a do-it-yourself approach to accounting software can cost double, triple, or more what it would cost to set it up right the first time.

Get the training you need to take maximum advantage of your software's features. Using these features on an ongoing basis will enable you to streamline your accounting system as much as possible. This will lead to you having a very efficient *and* effective system in place for all of your accounting needs.

Your Bookkeeping STINKS!

Commit Yourself to Success!

As you have seen by reviewing the above bookkeeping stinkers, there are many potential traps and troubles for you to fall into. The concepts or the number of things you need to know may seem overwhelming to you.

The good news is that your bookkeeping does not have to stink! There are many professionals who can help you fix your existing bookkeeping problems and help you get a better handle on your business finances in the future. Taken a step at a time, the process of transforming your business finances can be filled with success stories and, more importantly, better and more reliable information about how your business is doing.

The commitment to do this has to come from you. Without it, you are going to be doing things the same old way, making the same old mistakes, and wondering why you aren't making any money.

With your commitment, you can start running your business like a business. You will figure out how to improve your bookkeeping; manage your cash flow, inventory, and jobs with more accuracy; find new ways to add to your bottom line; and stop wrecking your plans for retirement.

Appendixes

Your Bookkeeping STINKS!

Appendix A

Checklist for Resolving Your Bookkeeping Stinkers (Tear out and tape to your desk!)

Stinker	My Bookkeeping Stinks!	Stinker Resolved
#1: Spouse handles bookkeeping	<input type="radio"/>	<input type="radio"/>
#2: Let staff handle payroll	<input type="radio"/>	<input type="radio"/>
#3: Software generates bad reports	<input type="radio"/>	<input type="radio"/>
#4: More than 50 accounts	<input type="radio"/>	<input type="radio"/>
#5: Bank accounts not reconciled	<input type="radio"/>	<input type="radio"/>
#6: No P and L statements	<input type="radio"/>	<input type="radio"/>
#7: No inventory-control system	<input type="radio"/>	<input type="radio"/>
#8: Mix business and personal expenses	<input type="radio"/>	<input type="radio"/>
#9: Disastrous estimating procedures	<input type="radio"/>	<input type="radio"/>
#10: No A/R management	<input type="radio"/>	<input type="radio"/>
#11: No plans for cash-flow crunches	<input type="radio"/>	<input type="radio"/>
#12: No fraud-prevention procedures	<input type="radio"/>	<input type="radio"/>

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Stinker	My Bookkeeping Stinks!	Stinker Resolved
#13: No fixed-asset tracking system	<input type="radio"/>	<input type="radio"/>
#14: Infrequent backups	<input type="radio"/>	<input type="radio"/>
#15: No automated purchase-order system	<input type="radio"/>	<input type="radio"/>
#16: No idea how much I owe the bank	<input type="radio"/>	<input type="radio"/>
#17: Poor credit card transaction tracking	<input type="radio"/>	<input type="radio"/>
#18: Poor job-costing tracking	<input type="radio"/>	<input type="radio"/>
#19: No financial statements	<input type="radio"/>	<input type="radio"/>
#20: Shoebox accounting	<input type="radio"/>	<input type="radio"/>
#21: I set up my accounting software myself	<input type="radio"/>	<input type="radio"/>

Your Bookkeeping STINKS!

Appendix B

Keeping Score? The Financial Reports You Will Need to Create to Stay on Top of Your Business Finances

Report	Recommended Frequency of Report
Profit and Loss	Monthly
Accounts Receivable Aging	Weekly (or at least monthly)
Accounts Payable Aging	Monthly
Job Profitability	Monthly
Sales by Customer	Quarterly
Sales by Item	Quarterly
Balance Sheet	Quarterly

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Appendix C

Failure Is for Real

A survey published by the U.S. Small Business Administration entitled “Financial Difficulties of Small Businesses and Reasons for Their Failure” revealed some very interesting statistics.² Of those filing for bankruptcy:

- “Financing problems” were reported by 28 percent of firms.
- “Inside business conditions” was the cause in 27 percent of cases.

“Financing problems” included:

- Poor credit-granting practices
- Excessive bad debts
- Inadequate borrowing practices

“Inside business conditions” included:

- No experience in bookkeeping or lack of understanding
- No knowledge of pricing
- Nonpayment of taxes
- Lack of planning

Summary: 55 percent of businesses reported problems that related to their finances or financial issues.

² Sullivan, Teresa, Elizabeth Warren, and Jay Westbrook. "Financial Difficulties of Small Businesses and Reasons for Their Failure." (Washington: SBA Office of Advocacy. 1999).

