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8 Small Business Accounting Errors and How to Avoid Them

Running a small business presents many challenges, which can draw one's attention in multiple directions at once. Keeping track of a company's finances is essential to its long-term success and growth. Unfortunately, far too many small business owners do not pay close enough attention to one or more critical financial issues. The following eight items are among the most common accounting mistakes that small businesses make, along with some tips on what owners can do to avoid them.

1. Not Emphasizing Bookkeeping

With all of the pressures that come with small business ownership, it can be easy to overlook bookkeeping. Business accounting requires owners to keep track of all transactions in order to make sure they have accurate books. Common issues that may arise from inadequate bookkeeping may include:

- Failing to track income and expenses, which can lead to underreporting income on a tax return or failing to take advantage of all possible deductions;
- Not reconciling bank statements and books; and
- Ignoring small transactions, like petty cash.

Accurate and thorough bookkeeping gives businesses a snapshot of how they are performing at any moment or over a month, quarter or year. Without this information, they could not only miss signs of potential problems but also opportunities for growth.

2. Confusing Profits with Cash Flow

The amount of profit that businesses make only tells part of the story. Business owners also need to pay attention to when and how they actually receive that money. A business might, for example, close a deal that will bring in $75,000 and require five months of work. It will need to spend $25,000 to complete the project. The company does not have a $50,000 profit the moment it closes the deal. It has to account for possible delays, cost overruns and other problems that can interfere with the project and delay payment by the client. Booking all of the profit right away could overstate how well the business is doing.

3. Overlooking Accounts Payable and Accounts Receivable

Businesses need to pay their bills. They also need to make sure their customers pay their bills. Failing to manage accounts payable effectively can harm relationships with vendors. If it goes on long enough, it can affect both the company's and the owner's credit rating. Without consistent attention to accounts receivable, a business might not have enough cash flow to keep operating. Accounting software can be a good first step for tracking bills and invoices.

4. Not Distinguishing Between Contractors and Employees

If a business has employees, it may owe them a wide range of legal responsibilities. It is responsible for withholding federal income tax and taxes for Social Security and Medicare from employee paychecks. It must also pay its own share of Social Security and Medicare taxes, as well as unemployment tax.

Independent contractors are responsible for handling their own payroll taxes. Employers that misclassify an employee as an independent contractor could face penalties, including fines payable to the government and damages owed to employees. Clear documentation of who is an employee and who is a contractor is essential.

5. Commingling Business and Personal Funds

It can be difficult for small business owners to separate business finances from their personal finances, but it is very important to do so. Blurring the lines between business and personal finances can have long-term adverse effects on both the business and its owner. From the moment an entrepreneur starts a new business, they should keep business assets and liabilities separate. This means opening a new bank account in the company's name and keeping business purchases separate from personal ones.

6. Insufficient Tax Planning

Business taxes are complicated no matter how small the company or its operations are. The manner of paying and reporting taxes will depend on the business structure. A corporation, for example, pays taxes on its income and files Form 1120 with the IRS. In a partnership or limited liability company (LLC), income passes through to the individual partners or members, who each pay tax on their share of the profits. Small business owners need to keep tax planning in mind from the beginning.

7. Not Backing Up Digital Records

Many businesses are going paperless, which offers both benefits and risks. They do not need to keep multiple large file cabinets in their offices, but they must make sure their digital records are secure. Generally speaking, it is a good idea to keep records related to business ownership, tax returns, employment, accounting and operations for at least seven years. Every small business should also have a backup system so they can recover data that is lost or damaged.

8. Trying to Keep All Bookkeeping and Accounting In-House

By now, it should be clear that small business accounting is a big job. One of the biggest mistakes many small business owners make is trying to do it all themselves. Accountants and bookkeepers are there to help. Their services can be invaluable to the growth of a small business venture.

Small business owners face many challenges, and accounting can often be a neglected area. However, overlooking accounting can lead to financial problems and missed opportunities for growth. Small business owners should prioritize accurate bookkeeping, distinguish between profits and cash flow, manage accounts payable and accounts receivable effectively, distinguish between contractors and employees, separate business and personal finances, plan for taxes, back up digital records and seek professional help from accountants and bookkeepers. By avoiding these common accounting mistakes, small businesses can ensure their long-term success and growth.

Contact us at www.fzacpa.com or (402) 496-9100 today to learn more about how we can support your business.