

TIPS *from* LauberCFOs

Improve Your Financial Statements by Avoiding Common Mistakes

Interim financial results are intended to give business owners and managers an ongoing picture of operating conditions. But there are common reporting mistakes that can distort that picture – mistakes that can lead to unpleasant surprises at the close of a company's fiscal year.

Common mistakes we have seen include:

- **Not properly recording depreciation -** Depreciation is properly recorded as a monthly non-cash expense. This includes depreciation related to assets acquired during the year. Failure to do so will inflate perceived profits on the income statement.
- **Failure to record assets purchased with a loan -** Failure to record assets when they are acquired is another mistake that can lead to reconciliation problems at year's end. An example of this would be the purchase of a company car with a down payment. If only the down payment is recorded, the missing loan payable could lead to embarrassment when the bank analyzes your financial statements.
- **Improperly recording asset purchases as expense or the maintenance expense as a fixed asset addition -** Consider establishing a minimum capitalization policy, say \$500, expensing all asset purchases below that amount.
- **Not splitting debt principle and interest into appropriate categories -** Payments on the principle should be recorded as a reduction in the liability while payments of the interest are an expense.
- **Not recognizing bad debts -** Bad debts are a reality for nearly every business. In accounting, they are considered an expense. How you record a bad debt affects the ability to write it off in accordance with IRS regulations. Waiting until year end to record write-offs distorts the interim financial picture and can lead to bad decisions.
- **Inventory valuation issues -** For companies that sell products, proper inventory valuation is important to provide a clear ongoing financial picture. This includes ensuring burden rates reflect current costs. Many companies base their cost of goods sold on the value of inventory remaining at the end of a period. If that inventory is not properly valued, a false picture can emerge. The situation can have a big impact on profits when inventory is valued based on a physical count at the end of the year.
- **Improper recording of project payments made in advance of delivery -** Long-term projects can present accounting problems when customer down payments are received but not properly recorded. If for example, a company requires one-third down before a project is launched, that payment should be recorded as a liability. The money can be moved into an income account as the work is actually accomplished to give a proper matching of revenue and expense.
- **Improper cutoff of revenue and expense figures at the end of a month –** It's not uncommon for a company to record revenue for a product or service but not record all the costs. For example, costs still to come related to a completed contract. Revenue and expenses need to be properly matched at the end of the month to avoid misleading financial

reports. Keep an eye on accounts payable processing, making sure that all items are properly recorded prior to closing an interim period. To ensure timely financial statements, estimates are OK for invoices that have not been received at the cutoff date.

- **Failure to accrue for once-a-year expenses like property insurance, officer life insurance, real estate and personal property taxes, etc** – To show a proper interim picture, it is appropriate to record 1/12th of these items on a monthly basis.
- **Not accruing for bonuses, commissions, profit sharing and retirement plan contributions** - The cost of bonuses, commissions, profit sharing, retirement plan contributions and similar payments should be evaluated throughout the year and not solely at the end of the year. Ideally, such payments should be recorded on an accrual basis since, in effect, they are earned throughout the year.
- **Investigating only negative variances** – If results are too good to be true, they probably are. Investigate both positive and negative variations.

The above is only a partial list of common mistakes that can obscure the true financial picture of a business. Take a

look at the adjustments your accountant makes at the end of the year to find out which areas your specific business should address. Then make a commitment to monitor those areas more regularly.

A key tool to ensuring credible interim financial reports is having a plan and comparing monthly results to that plan. When investigating deviations from the plan, often recording errors are uncovered.

By keeping on top of the above items on a monthly basis, your year-end bookkeeping will present fewer surprises and headaches. Further, the ongoing monitoring will allow you to address situations in a timely manner and prevent negative situations from being compounded..

Another thing to consider during the year is to separate Travel & Entertainment expenses into separate accounts in line with IRS deductibility rules. This will simplify your year-end closing.

If you'd like to discuss methods to keep your accounts reconciled, give us a call at 414-273-8060 or, outside of Milwaukee, at 800-358-8060. You can also send us an e-mail at John.Lauber@LauberCFOs.com. One of our LauberCFOs would be happy to confidentially discuss processes to ensure interim financials are recorded in a proper, timely manner to avoid year-end surprises.

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