Top 5 Accounting Errors and How to Correct Them

Most business owners love the work they do and usually have a good understanding of the financial operations in their companies. But, they don't necessarily grasp the nuances of accounting and that can often cost them huge amounts of money.

As an accounting firm, RBF has worked with many very successful businesses and we've seen a pattern of accounting errors that we've been able to help our clients correct. Here are the top five that we've encountered:

"To state the facts frankly is not to despair the future nor indict the past. The prudent heir takes careful inventory of his legacies and gives a faithful accounting to those whom he owes an obligation of trust."

- John F Kennedy

1. Sloppy Accounting Practices – Businesses grow and expand and we often see that the systems and processes in accounting slip behind due to the daily fires that consume the business day. ***Every business should set formal, documented and detailed procedures for managing bookkeeping and accounting functions.*** Investing in accounting software that is cloud based is a major way to stay current with accounting technology because of automatic upgrades and also protects your data in the event of fire or theft.

2. Ignoring Your Budget or Working without a Budget – Many companies go through the budgeting process and promptly ignore it. Budgets are a

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- Packaging
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roadmap for managing your money and should be a reference point to keep spending under control and within the constraints of your revenue. ***Build a budget conscious culture in your company and reap the rewards of a more efficient and profitable organization.***

3. Sales Projection Errors – Accounting errors aren't always about money earned and lost. Sometimes financial mistakes can emerge as a result of poor sales projections. Sales projections can be used to predict profits and losses ahead of time, but are only good if they are well-researched and realistic. Economic trends and sales patterns should be carefully monitored in order to make timely changes that can minimize your damages.

"You have to understand accounting and you have to understand the nuances of accounting. It's the language of business and it's an imperfect language, but unless you are willing to put in the effort to learn accounting - how to read and interpret financial statements - you really shouldn't select stocks yourself"

\- Warren Buffett

4. Confusing Profits for Cash Flow – Showing a profit on paper is very different than having cash in the bank and that's a difficult thing for many small business owners to understand. Funding research and development, making large equipment or software purchases and not being careful about accounts receivable are major ways that we see companies getting into trouble with their cash flow, even though they are showing a profit on paper. ***Track spending versus sales and take a long, hard look at your true financial picture before you move forward with new expansion plans, additional hiring or capital expenditures.***

5. Ignoring the Ratios – Ratio analysis is the single most important technique to determine trends in your business and expose weaknesses

JEFF BLEACHER

"The biggest accounting mistake that small businesses make is failing to create a budget. It should be used during the year to compare to actual results to see if you need to obtain new revenues or reduce expenses. A budget is an effective management tool to determine if you need to make any operational changes. The biggest problem with larger companies that we see is that they have not established accounting practices/procedures and adequate internal controls. Without consistent procedures you may not have good and accurate records. Without adequate controls, the chances for error and fraud are more prevelant. These can both be prevented and corrected with our help."

KEN FALK

"Learning how to read financials, including the balance sheet, and understanding the implications of these numbers is an area where many of our clients have trouble. When a company owner only focuses on the P/L or short term numbers he or she may not see the bigger picture that represents the true financial situation of the company."

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that may be hiding otherwise. Track your Quick Ratio, which is an indicator of your company's short-term liquidity. This measures your ability to meet your short-term obligations with your most liquid assets. The higher the Quick Ratio, the better the health of your company. This is sometimes called the "acid-test ratio" because it is such a clear indicator of your company's financial picture. Tracking your Current Ratio is also important because it includes inventory, but may overestimate your short-term financial situation if you can't turn your inventory into cash.

> "It has been my experience that competency in mathematics, both in numerical manipulations and in understanding its conceptual foundations (accounting), enhances a person's ability to handle the more ambiguous and qualitative relationships that dominate our day-to-day financial decision-making"
>
> – Alan Greenspan

By identifying these errors in your accounting practices you can correct them and maximize your profits while minimizing your losses. ***Talk to the RBF team to help analyze your specific situation and make your business more successful.***

LARRY REICH

"Inconsistency in accounting practices is one of the biggest problems we see. By that I mean that sometimes a transaction is recorded one way and then a similar transaction is recorded differently. Recording similar transactions differently makes analysis of the data harder. By setting guidelines, procedures and practices, clients would be able to produce much cleaner records and have a better understanding of their financial picture."

PATRICK GENDRUE (on the left)

"There are several top issues that I see with clients: the most damaging is not collecting on accounts receivable. The most easily committed error is not keeping a good set of accounting records. The one that has the most impact on cash flow is tying up cash in inventory. These issues can be corrected with professional help."

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Ross Buehler Falk & Company, LLP
Certified Public Accountants

1500 Lititz Pike
Lancaster, PA 17601

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717-393-1743 (fax)

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RBF is a Lancaster, PA CPA and consulting firm specializing in providing accounting and consulting services with the highest integrity.

Accounting Tips: The Devil's in the Details

Accounting starts with the basics of money in – money out. But tracking that money can be fraught with problems, most often due to human error. It's easy to be distracted in our busy business world and then lose focus on the accounting task at hand. That's when these tiny errors often happen. Tiny errors, huge impact. For example:

Entering the Wrong Amount – Your eyes can easily be tricked out when you have a long list of numbers to enter. You can enter info from the wrong line because your eye may wander from line 9 to line 11 and suddenly your entire spreadsheet is off. Or you may hit the wrong key unknowingly. Or you may transpose a number if you're going too fast.

Posting in the Wrong Account – It's not unusual for someone to accidentally record or post something to the wrong account. It may have been an account that was either above or below the one that should have been selected. This kind of mistake can be avoided by focusing attention on one account and posting all entries for that account before moving onto the next one.

Not Catching Software Mistakes – You may have to keep a sharp eye on software nuances that could result in posting mistakes. For example, different software systems might enter this number differently: 146800. If a system automatically enters commas and decimal points, then you would end up with $1,468.00; the intended amount to be entered. But, if your system requires manual entry you could end up with a posting of $146,800.00; clearly not the right amount. So, make sure that you know your system well and that anyone posting in the system is following the same process.

Confusing Accrual Accounting with Cash Accounting – These two different systems of accounting can lead to a big misunderstanding of what your true cash flow is. Accrual accounting matches costs against revenue in "accounting time," while cash accounting tracks money in and money out in real time. The problem with cash accounting is that you may have cash that is not actually yours because you have a bill against it which hasn't come in yet. This is a problem many small business owners have and causes major issues in managing their money. For example, an advertising agency received $250,000 in advance for a media purchase they were making for a client. When they didn't get a bill from the media company for two months they began thinking they were cash rich and both partners bought new cars. Because the media company was late in sending out the invoice, the ad agency didn't have the media money when it was due. This one mistake began a downward spiral for the ad agency and within two years they were out of business.

Keeping Accounts Receivables Clean – It's not a sale if you don't collect the revenue, so keep up to date on your A/R. If you are paying vendor bills against a project and not collecting the money, your cash flow will be impacted. If you have to tap your line of credit as a result, then you are also paying interest against borrowed money and eroding your profit on the project. Become an A/R cop and enforce payment terms. Don't be your vendor's banker.

These simple errors are avoidable when an organization is vigilant about its finances. Most accounting errors are a result of human error or lack of knowledge about how a system works. Working with an accounting firm like RBF can help your organization track down errors and find solutions to keep them from happening again. Your financial health is our greatest concern and giving you help with the details, as well as the big picture, is our mission.

"Smart people learn from their mistakes. But the real sharp ones learn from the mistakes of others."
– Brandon Mull, *Fablehaven*

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Ratios Rule…

RATIOS RULE!!

Knowing the true health of your company starts with tracking these 3 simple calculations from your balance sheet:

Balance Sheet - Sample Corp. Fiscal Year (FY) 2011, 2012

	12/31/12	12/31/11
ASSETS		
Current Assets		
Cash	$45,000	$40,000
Marketable Securities	$65,000	$60,000
Accounts Receivable	$85,000	$70,000
Notes Receivable	$45,000	$40,000
Inventories	$85,000	$80,000
Total Current Assets	$325,000	$290,000
Long-Term Assets		
Land	$85,000	$80,000
Buildings	$100,000	$90,000
Machinery	$30,000	$25,000
–Accumulated Depreciation	($4,000)	($3,500)
Net Tangible Assets	$211,000	$191,500
Intangible Assets		
Goodwill	$15,000	$5,000
Patents	$20,000	$19,000
Trademarks	$15,500	$13,400
Copyrights	$24,000	$22,900
Total Intangibles	$74,500	$60,300
Other Assets		
Investments	$25,000	$23,000
Deferred Charges	$50,000	$45,000
Total Other Assets	$75,000	$68,000
Total Long-Term Assets	$360,500	$319,800
Total Assets	$685,500	$609,800

	12/31/12	12/31/11
LIABILITIES and OWNERS' EQUITY		
Current Liabilities		
Long-Term Debt – 1 Yr.	$12,000	$11,000
Notes Payable	$15,000	$14,000
Accounts Payable	$13,000	$12,000
Taxes Payable	$11,000	$10,000
Accrued Expenses	$21,000	$20,000
Other Current Liabilities	$10,000	$9,000
Total Current Liabilities	$82,000	$76,000
Long-Term Liabilities		
Notes Payable	$30,000	$27,000
Bonds Payable	$60,000	$52,000
Total Long-Term Liabilities	$90,000	$79,000
Other Liabilities		
Pension Obligations	$90,000	$82,000
Deferred Taxes	$70,000	$62,000
Minority Interest	$15,000	$12,000
Total Other Liabilities	$175,000	$156,000
Total Liabilities	$347,000	$311,000
OWNERS' EQUITY		
Preferred Stock	$60,000	$50,000
Common Equity		
Common Stock	$97,500	$89,000
Capital Surplus	$111,000	$99,000
Retained Earnings	$120,000	$105,800
–Treasury Stock	($50,000)	($45,000)
Total Common Equity	$278,500	$248,800
Total Owners' Equity	$338,500	$298,800
Total Liabilities and Owners' Equity	$685,500	$609,800

1 CURRENT RATIO

Calculation =
Current Assets ÷ Current Liabilities

Measures Solvency:
The number of dollars in Current Assets for every dollar in Current Liabilities.
For example: a Current Ratio of 1.50 means that for every dollar of Current Liabilities, the company has $1.50 to pay the liability. The higher the ratio the better.

2 QUICK RATIO

Calculation =
Cash + Accounts Receivable ÷ Current Liabilities

Measures Liquidity:
The number of dollars in Cash and Accounts Receivables for each dollar in Current Liabilities.
For example: a Quick Ratio of 1.15 means the company has $1.15 to pay for every dollar in Liabilities.

3 DEBT-TO-EQUITY RATIO

Calculation =
Total Liabilities ÷ Total Equity

Measures Financial Risk:
The number of dollars of debt owed for every dollar in Equity.
For example: a Debt-to-Equity ratio of 1.15 means that for every dollar of Equity that the owners have invested, the company owes $1.15 of debt to its creditors.

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