Why Bookkeeping is So Important for the Success of Your Business

Bookkeeping is often dreaded by small business owners. The reason may be that bookkeeping seems both tedious and time consuming. And while many small business owners realize the importance of bookkeeping, few feel they have the time or resources to ensure it is done properly.

Accordingly, in this issue of the *TS Newsletter*, we discuss why bookkeeping is so important while also providing several useful tips and examples, and we encourage you to contact us if you have any questions.

What's at Stake

Most importantly, accurate bookkeeping will give you the records to objectively analyze your business, allowing you to identify which areas are working well while also pinpointing problems. For example, you may notice that sales are up 20% but receivables are up 40%. So, while your employees may be doing an excellent job of booking sales, they may need additional tools and training to get customers to pay.

Additionally, accurate bookkeeping is one of the best forms of audit protection. Most businesses face a dizzying array of taxes and filing responsibilities, and if your business is ever audited, you will need to provide adequate records to support the tax returns which have been filed. If you don't provide these records, an auditor is likely to redo certain tax returns, often to your disadvantage. Also be aware that a single audit assessment can put you out of business.

Aside from internal analysis and audit protection, adequate records are often required when dealing with outside lenders and investors. Such records may even be necessary in order to deal with certain vendors, and they are crucial when you are selling your business or otherwise transferring ownership.

Adequate Records

Reconciled bank statements form the foundation of adequate records. Every deposit into or withdrawal from the business bank account must be accurately recorded, whether or not it impacts the profitability of the business. For example, if you loan $5,000 to your business, you will need to record the deposit into your business bank account as a loan.

Failing to record a transaction is a very common and potentially costly mistake. One of the many problems with not recording a transaction is that it may be incorrectly categorized when the bank account is later reconciled. For example, if the $5,000 loan from the owner was not recorded at the time it was deposited, the person who later reconciles the bank account may record the transaction as sales.

Recording a loan as sales would result in overstated business profits and likely, a higher tax bill. Not surprisingly, this is likely what would happen if an auditor reconciled a previously unreconciled bank account. So it's important to create and follow a system which ensures that all transactions will be accurately recorded and that the bank account will be reconciled at least once per month.

Aside from recording all transactions and regularly reconciling the bank account, businesses should retain all records which support the financial statements and tax returns filed, such as:

- Bank Statements and Reconciliation Reports
- Cancelled and Voided Checks
- Payroll Reports and Employee Files
- Vendor Invoices
- Expense Reports and Petty Cash Receipts
- Credit Card Receipts and Statements
- Invoices Sent to Customers
- Shipping Records

Reconciling the Bank Account

Small business owners can benefit from reconciling the bank account. Most small business owners sign the checks and take the deposits to the bank[1], so they are generally in the best position to determine if a deposit or withdrawal is appropriate. Additionally, reconciling the bank account helps business owners better understand their cash flows, which is critical for success.

Learning to reconcile the bank account may seem daunting, but it's generally very straightforward. And once you know how to do it, reconciling the bank account usually takes very little time each month. Also, current software programs like QuickBooks® further simplify the reconciliation process.

The first step to reconciling the bank account is to examine the cancelled checks. Be sure that:

1) each check is made payable to an appropriate party,
2) the amount of each check seems reasonable,
3) the signature on the face of each check is legitimate,
4) and the endorsement signature appears appropriate.

The next step is to verify that the beginning balance on the bank statement you are reconciling matches the ending balance from the month before. Next, subtract the ending balance from the beginning balance on the current bank statement. This is the amount you need to clear in your internal records.

While clearing deposits and withdrawals in your internal records, enter any missing transactions and identify any transactions that appear questionable. Follow up on questionable transactions, uncleared transactions, and irregularities with the cancelled checks. That's basically it!

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[1] Generally, small business owners should sign all outgoing checks and deposit all incoming payments to deter cash misappropriation.