7 COSTLY MISTAKES WHEN REVIEWING YOUR ACCOUNTS

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Introduction

My name is Penny Lowe and I have been running my accountancy practice since 2003. Over the time I've seen many clients who have previously been with other accountants.

When they take me on as their accountant, I won't let them 'just sign here' but talk through their accounts with them. Over a period of time, their understanding of the figures grows to the level where they not only help me in producing accurate figures, but we use them to help the business go forward. This may be growth, survival or exit, but whichever they choose, they appreciate how key it is to have the correct figures.

If you become an accountancy client, you sign up to education whether you want it or not! What follows are examples from clients I have taken on, or those that have asked for help, or occasions where reviewing the accounts in detail, and with greater understanding, would have caused a different outcome.

1. Believing You Don't Need To Look At The Accounts

Are you someone who at the end of the year receives your accounts, signs where instructed and never looks at the detail? Is the only thing you are interested in is how much tax you need to pay?

If you are, you are one of many who take this approach. You pay the accountant so why should you get involved? The answer is because it is YOUR business. Unlike being employed where you know how much you will earn and each month the money arrives in your account, being a business owner means it is your responsibility to ensure you and your staff get paid.

Even if you chose not to look at your accounts others will. Whether it is potential customers wanting to know you are a stable business, banks deciding whether to lend you money or suppliers allowing you to open an account.

I have had a client who has been operating as a sole trader for seven years when he came to me. He then passed me a letter from another accountant claiming it was actually a partnership. When I challenged this he said he has seen some signed accounts from five years ago showing it was a partnership – my client had thought it was joint venture for a single project. We are still trying to sort out the situation and unpick the situation. Both parties now have to pay professionals to sort out the mess and avoid HM revenue and Customs penalties. If my client had looked at what he was signing he would have challenged the accountant at the time.

It is your responsibility to look at the figures and ask questions. Typically you will have a gut feel but is that confirmed by the accounts? If you don’t look how will you know?

At the end of the day by signing the accounts you are confirming your responsibility to yourself and third parties including HM Revenue and Customs.

2. Using Incorrect Or Incomplete Figures

Decisions should be based on facts. Facts should be accurate otherwise they could be called best guesses.

If you go into a shop to buy something you will ensure you have sufficient funds to pay. If you don’t, you know the consequences.

If you make decisions based on inaccurate information how do you know if it is the right decision. A publican who has not recorded all his bills for beer may think he is doing all right. The true picture may be very different especially if he is having a high wastage due to how he is storing his beer. When reviewing accounts it is worth doing a common sense check. When I recently looked back at the last two years of accounts for a new client, two vans had not been included, there were no costs for the internet and yet they had been emailing me information. Another client has no cost of travel and yet I knew he travelled to see his clients and accountant.

The worst case I have seen was a business that showed ownership of a building valued at over £1 million in the accounts that had been sold two years previously. The accountant preparing the accounts had probably used last year's accounts and changed the figures but not all of them. Three years later, I was called in by a client as there was a £20,000 discrepancy that neither the external auditor or the client could track down. I eventually found it to be a bank account that the auditor was including that had been closed at the start of the year.

In both these cases it is not just yourself who is being misled as to what the company has, it is everybody using the accounts.

So whether the errors are PayPal sales not being included, cash wages not being declared or bad debts not being written off, the figures are blatantly wrong. When using these figures to make decisions you are not going to be able to be sure it is the right decision. If you say you don't care, fine, but the taxman will when he decides how much tax you owe him and then finds he has relied on incorrect figures.

3. Not Understanding What You Are Looking At

If someone gave me a circuit diagram for a car it wouldn't mean much to me. As a user, I know that when I turn on the ignition I want the car to start, when I turn on the wipers and washer they should clean windscreen. Do I need to understand the circuit diagram? No, not in detail if I have someone that can translate it for me.

If I am going to take responsibility for the car I should know how to check a fuse and water bottle and know when to seek help from a professional. You don't have to be able to fix it all yourself but you do need to know enough to know when to seek help. The important factor is understanding enough so you can ask questions and understand the answers.

A client who has been running her business and generally does understand what she needs to about the profitability of her business, recently received an offer to buy her out. She approached me, showed me the offer and asked my opinion. We went through in detail and made sure she understood what every figure meant. At the end of the day such decisions also have non-financial factors. It would be down to her whether she wanted to continue working or retire. If she sold up, what would she do with her time? How would she choose to generate an income or how long could she live on the money she would get from its sale?

By understanding the figures she was in a much stronger position to know what was actually being offered. Also by seeking professional help she could understand the potential capital gains tax implication of accepting an offer.

For the day to day running of the car or running of the business there is a level of understanding that makes the difference as to whether it is relaxed and continues to run or expensive repairs are needed. Not checking the oil and never putting any in will result in a seized engine and no transport.

Not seeing your overdraft is growing or bills are not getting paid may result in the business being closed down by a third party. So staying in control by understanding what is going on and asking questions will expand your knowledge and help you grow the business.

4. Looking At One Year In Isolation

Every business has peaks and troughs, so looking at one year will not give you the full picture.

In the same way, if you have a seasonal business, one month in isolation will not show where you are in the year. An ice cream seller will expect less sales in February than July. A business that sells Christmas trees would expect very few sales in July.

The same can be true across the years. In early years of a new business there are many start-up costs that do not happen in later years. The creation of a web site might be one of these where the maintenance in subsequent years is much less than the initial outlay.

If you are looking at figures for a year, the first comparison to make is within the trading and profit and loss account. Can you justify why this year is different from last year? If not, why not? If so, are you happy with why the difference has occurred or do you need to take action?

Working with one client recently we discovered that the amount owed by customers last year was £279, while this year it was £8,000 plus. The difference was that the previous accountant had not included all sales invoices issued on the last day of the year. This meant that sales were also not recorded for the year. This amount to 10% of the sales for the year. Yes, they had therefore paid less tax that year and more the year after when they were recorded, but they had also presented incorrect information to Companies House, H M Revenue and Customs and most importantly, misled themselves as to how well they had done during the year.

A simple check of this year against last year would have quickly highlighted this extreme difference.

5. Leaving It Too Late To Have An Effect

If you were told that your rent had doubled, and by the way this was effective from twelve months ago, how would you feel? If you find out that you have been double paying the rent for the last year, would you feel any better?

You may think that at least with the second scenario you can get a refund. If you are lucky you could do but what opportunities have you missed because you did not have the money at the time? How much interest have you paid on bank overdrafts or credit cards? You won't get that money back.

You might say this is an extreme example but I have found clients paying rental for equipment they no longer use but have not sent back and cancelled the agreement.

An unfortunate tale is a client who had a long gap between when they had to pay for goods, up front prior to manufacture, and when they were paid by their customer who was a national company and insisted on 90 days credit. The client used invoice finance to cover the delay of cash but did not appreciate or include the costs when working out the selling price for the customer. Due to the cost of finance, the client was making a loss from this and a couple of other large customers. The company went into liquidation and my client is no longer running a business. He is doing well employed by someone else where he is given the minimum selling price so no longer has to worry about that. He is in a much stronger position to negotiate only within the range given as he knows the consequences of selling too cheaply. You might get the sale but do you lose the business?

Another example of leaving it too late is chasing customers that owe you money. Not only should the money be in your pocket, not theirs if they owe it to you, but if they are not in a position to pay, you need to take action.

If you had planned on £20,000 coming to you in two months' time but an update says it might be four months, and reality turns out to be that the company is closing and you will never get it, you may understand why you want to know as soon as possible. Not only will it impact on what you can pay but if there are goods you can retrieve or putting a stop to supplying further goods and services it prevents the situation being compounded.

Look at the figures as often as circumstances demand. If cash is tight this may be every day. Also consider what figures and remember what you are looking out for.

6. Not Doing Anything As A Result

If your house was on fire you would dial the emergency services for help. If you see a decline in sales or profitability what do you do?

Some business owners will want to leave it a bit longer and see if it improves. This is easiest route but not the safest. What are the chances of reaching your destination if you have taken a turn and no longer know what road you are on.

I had one client who couldn't understand why their bank balance was going down when they thought they were not doing badly. I found he had changed credit card terminal supplier and all his card takings were going to an old account he no longer used. When we tracked this down, he found he had many thousands in that account but he had given himself one more week or he was going to close the business.

The same client also started checking his daily takings and found one member of staff had been helping himself out of the till. The member of staff did not object when he was instantly dismissed. I wonder how much money my client had lost in total. It is critical that you put systems in place and then monitor the results so that you can take action as soon as the results are not what you expect. The examples above may all seem rather negative, so on a more positive note, as you notice your sales are increasing dramatically do you need to put things in place to support them. It could be additional purchases so you don't run out of stock or additional staff to fulfil the orders to ensure you can still offer the same level of service. You know your industry and what needs to be done to support the increased sales.

Also has a new market been discovered you that you can promote to? You need to take action based on what you have learnt.

7. Ignoring The Cash Flow Implications

Although the historic figures, when correctly recorded, are historical and cannot be changed, the decisions made based on them can seriously affect the future of the business.

If you know how much you are due to receive and how much you have to pay out, you will know whether you can meet your commitments.

If you have plenty of money in the bank, is it being use wisely? I am not going to try and define what is wisely for you, as there are many factors that would affect my response.

If the figures imply that your business is broke, this is not necessarily true as there may be a large amount of cash received just after the figures were prepared and therefore it would have been correct not to include the cash. However it may have made the difference on the bank foreclosing on the account and your opportunity to expand the business. This is not uncommon with a small business that may land a large sale only to find out the client is a slow payer. My advice in any sticky cash flow position is keep talking to those you owe money to. Last week I received a payment proposal from a client that has bills due from two years ago. He has paid a chunk of money about every three months to date so I know patience will be cheaper than court. He also appreciates the gesture when in fact it is for financial reasons rather than just being a nice person that I have been prepared to accept regular small payments rather than none.

Whether it is suppliers that need to be paid, or customers that are not paying on time, planning cash is a very important exercise when looking at the accounts.

Summary

Being responsible for money is a burden that you cannot escape from. It is not only your future that is in your hands, but those of your staff, suppliers and customers. You might ask why I say customers, but if you have a good relationship with them, and take care of them, they will depend on you to be there. Whether it is for future purchases from you or payment of bills, your decisions will affect many more people than you imagine.

Even if you are a small sole trader with no staff and no dependence, you owe it to yourself to run the business so that you can be financially comfortable and your customers can be happy and know you are there for them in the future.

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