11 FINANCIAL MANAGEMENT & ACCOUNTING MISTAKES MADE BY SME's AND HOW TO FIX THEM

UK Statistics reveal that about one third of all small businesses launched in the UK will fail within the first three years. There are many reasons for this but the main cause of small business failure is poor financial management.

Financial management may sound like some fancy jargon used by accountants and bankers but it involves every day issues in your business. Issues such as managing your cash flow, deciding how much inventory to hold, choosing between buying assets or leasing them, understanding the tax impact of different decisions and so on. Many new business owners do not pay attention to financial management until they start running out of cash and sometimes it is already too late to save the business.

Sound financial management starts with an understanding of some basic rules of finance, accounting and bookkeeping and in many cases it involves a good dose of common sense. So here are 11 of the most common accounting and bookkeeping mistakes made by new and start – up businesses…. and how you can avoid making them.

1. Failing to Prepare a Business Plan and Business Strategy

Right from the start up of your business you need to prepare a business plan that looks at all the different parts of your business. However, many new or start-up businesses do not have a written business plan or business strategy. Some businesses develop a business plan only because the bank or financiers asked for one and for many of these businesses it's just a case of ticking the right boxes to raise finance. Every business will encounter problems along the way and often, the business that took time to prepare a plan is more likely to have anticipated the problems and developed contingency plans to cope. The business with a strategy will always have a clear path to resolve conflicting ideas, issues and challenges. The business without a plan will end up fighting fires and never settling down to focus on its core competencies. Failure to fully research your business opportunity right from the start is one of the main reasons for business failures and can lead to huge personal debts for business owners and investors.

To avoid this mistake, you need to start preparing your business plan even before the business is formed. A good business plan provides a road map that covers your sales, your costs, your cash flow, your assets base etc. In fact, your business plan is made up of the basic building blocks that bring your business alive and takes you towards your long term strategy and vision.

The major benefit of a business plan for a new or start-up business is in the research you are forced to carry out in areas such as market research, competitor research, customer research, funding requirements and so on.

2. Combining Personal and Business Finances
It's critical that you do not mix personal and business finances, regardless of your company's size. That's why one of the first things new business owners should do is open a business current account and deposit all business income into this account and make all business expenses from the same account. It is shocking to see how many business owners treat company funds as personal funds and kill their businesses by taking too much money out of the business when it is still not financially able.

To avoid this mistake, you need to work to devise an earnings management strategy that dictates how much cash can be removed from the business to meet personal expenses and savings goals. Your earnings management strategy will be driven by such factors as how much profit after tax was available for distribution, how much of your profits need to be reinvested back into the company, the timing of payments for large business expenses, your cyclical or seasonal cash flow needs, and your long-term personal financial strategy. A related mistake is where company directors take too much money out of their company. This is known as overdrawing the director’s account and can sometimes lead to a hefty additional charge of 32.5% in addition to the corporation tax bill.

3. Failing to set aside funds to pay tax bills
There are various tax charges that arise as a result of how you have structured your business. Some of the main taxes are VAT, Corporation tax, PAYE and NIC.
Paying your taxes late can lead to costly fines and penalties that have an adverse impact on your cash flow.
Not paying your tax bills is a serious matter and can lead to criminal prosecution if fraud is involved and can also lead to loss of your business. It doesn’t end there either because HMRC has the powers to go after your personal assets in certain cases.

In order to avoid these mistakes, you need to make a conscious effort to put the “tax man’s” money aside. When it comes to taxes like VAT and PAYE you are just an unpaid tax collector holding the tax money in trust, so I always suggest to my clients that they open a separate account for these funds and to pay them to HMRC at the right time. Don’t fall into the trap of borrowing some of the money and then not being able to pay it back. HMRC treats this as fraud. If you are having cash flow problems, talk to your accountant early so that they can come up with a funding plan that works.

4. Failing to Keep Accurate Business records
Maintaining proper and accurate records are a legal requirement and you can actually pay penalties of up to £3,000.00 for failure to keep proper records. In 2010, HMRC carried out a study which indicated that 4.9m UK businesses suffer from poor record keeping and HMRC planned to target 40% of these companies with a view to penalising those who did

not keep adequate records. Don't become one of the small and medium businesses penalised for failing to keep proper records .

More importantly, if you want your business to be successful, it is essential that you do not keep proper records just because it is a statutory requirement. You should keep proper records because if used properly your business data can be like your GPS/SATNAV and provide you with the information and feedback to help you drive in the right direction to your target.

To avoid this mistake, you need to make sure that you keep all the basic records and documents required by law. You should also reconcile your business's books with your business bank statement every month. As your business grows you will also need to reconcile other aspects such as creditor's balances and debtor's balances to ensure that your financial records are accurate. This helps ensure that accounting errors are caught and corrected quickly before they result in major financial problems. A good accountant can help you ensure that your records and filing systems becomes an asset to your business.

5. Poor Petty Cash Management

Many businesses keep an informal stash of "petty cash" that can be used by employees and directors to cover small and incidental business expenses, such as postage stamps, public transport and office supplies. But just because the amounts are small doesn't mean that petty cash shouldn't be accounted for properly. There are cases of petty cash not accounted for over the years adding up to thousands of pounds. Sometimes the employees have left the business by the time the balances become an issue.

In order to avoid this mistake, a petty cash imprest system needs to be set up. This is a simple accounting system for petty cash that fixes a maximum figure that can be put into the petty cash float and petty cash vouchers are used to support employee receipts and bills.. What this means is that at no time must the total of the physical cash and the unredeemed vouchers be more than the fixed amount set. For example, if an employee needed cash for a business trip, he would have to provide all the receipts and paperwork from his last trip before the money is replaced in petty cash.

6. Failing to Understand the Difference between Profits and Cash Surplus

A business can have positive cash flow in the short term but still be unprofitable. conversely, it can have negative short-term cash flow but still be profitable in the long term. Companies like Google and Facebook did not make any profit for many years but they had positive cash flow. Many small businesses are not profitable in the short term but they need to have positive cash flow.

It sounds obvious but it's surprising how many decisions are made by businesses without a thorough understanding of the cash flow impact. Cash is the life blood of your business and if you run out of cash the business dies.
At start up, it can be tempting to invest in stock and to sell goods on credit without adequate credit checks or without setting credit limits.

In order to avoid this mistake you need to understand that "Cash is King" and cash is the life blood of your business. As long as your business is generating a positive cash flow it can survive the early years even if there is no profit. However, you need to beware of sustained losses mounting over the years.

Make sure that you prepare a cash flow forecast that covers the essentials such as cash inflows, cash outflows, funding gaps, payback periods etc. Make time to review the forecast and update it frequently in line with the realities in your business. If you identify seasonal or short term funding gaps, an overdraft facility is a good thing to have in place to cover any shortfalls in cash flow. A good accountant should be able to help you prepare a living cash flow forecast and help you identify appropriate funding to meet your business requirements. As your business starts to grow, you will need regular cash flow Statements to guide your decisions. Proactive business owners look at their financial statements regularly,not just once a year.

7. DIY Tax Planning and Accounting

Many small business owners pride themselves on their ability to wear many different business hats, including the accounting and bookkeeping hat. However, this is one area where small business owners are usually much better off hiring a qualified and experienced specialist rather than trying to do it themselves.

Accounting and bookkeeping can get very technical and complex and errors can quickly lead to significant penalties and fines. Late filing of documents can have an adverse impact on a company's credit rating and by extension on its access to finance

Finally, you need to realise that the most important function for the business owner is that of finding new customers and keeping the existing customer. Anything that distracts you from this function can become a huge problem for the survival of the business.
To avoid this mistake, talk to an accountant who can explain how to save you enough money to pay for the fees. If you get it right the money spent to hire a qualified and proactive accountant, even on a part-time or contract basis, will usually come back to the business owner many times over given the time saved, tax saved and all the mistakes and penalties that will be avoided.

8. Not Implementing Adequate Internal Controls
A 2011 study by Kroll Business Intelligence and Investigations found that 60% of frauds are committed by insiders. Many small and medium sized business owners tend to underestimate the adverse impact of internal fraud on the survival chances of their new business. If proper checks and balances aren't implemented in a business's accounting system, there may be opportunities to commit fraud and embezzlement. Losses from internal fraud have been known to significantly cripple a small business, or even lead to bankruptcy.

The best way to guard against internal fraud is to implement solid internal financial controls. This includes segregating of financial duties so that no one employee has unfettered control of every aspect of the business's finances. If it isn't practical for you to hire more than one bookkeeper, you could get an external accountant or personally oversee the bookkeeping and bank reconciliation work and keep tabs on it yourself.

9. Making Decisions Without Proper Management Accounts
Many small and medium sized businesses continue to prepare only statutory accounts because they are required by law and for calculation of tax. The problem with statutory or year end accounts as they are generally known, is that they are backward looking in the sense that they tell you what happened in the past. Think about it for a second… what is the point in knowing that your business is in trouble, one year after it happened? Many new businesses fail because their owners had no visibility of the key issues until it was too late.

As your business activities increase, the best way to understand what is happening in your business and to match all your income to the relevant expenses and product lines is to prepare regular management accounts and implement key Performance Indicators (KPI's). It is important to know what you want to track as early as possible and discuss how this can be built into your accounting and reporting systems. Remember, if you can't measure the return you get on each project, each marketing campaign, each investment, then you might be wasting your money.

10. Classifying Workers Wrongly
In the eyes of HMRC (the taxman), there are several different categories of workers, such as full-time, part-time, and temporary employees, as well as self employed workers, such as freelancers and consultants.

Classifying your workers in the wrong categories can be extremely costly, especially for new business owners who are not up to speed with the rules.
These worker categories are often used to determine what level of pay and national insurance contributions are due. For example, Full-time employees are generally covered

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by minimum wage legislation, and entitled to all benefits offered by an employer such as holidays, maternity, redundancy and so on. On the other hand, temps and self employed workers generally receive no benefits, and independent contractors are not covered by minimum wage, overtime, payroll tax, workers' compensation, or unemployment compensation laws.

Costly fines and penalties can arise if a worker is wrongly classed as self employed when in fact all their activities and work practices indicate that they are actually an employee.

In order to avoid this mistake, you need to prepare a resource plan that clearly details the different skills you need in your business and how these needs will change as the business grows. Sometimes it may be a good idea to outsource some of the work to other companies that specialise in these services and gradually bring in your own employees when the work load justifies it.

11. Matching Short term Funds to Long Term Projects

The way you raise finance and fund your business has a critical impact on the survival of the business. Many start-up businesses apply a mix of finance from the owners, family and friends and the bank. There is nothing wrong with financing your business from multiple sources but problems can arise when you fail to match the tenor (duration) of the funds to the life of the project. For example it is risky for you to use an overdraft for anything other than short term cash shortfalls. Yet, you find some businesses using their overdraft to finance the purchase of long term assets.

To avoid this mistake, you need to match your funding to the expected life of the project or asset. Use share capital as the ultimate risk capital and make sure you select your shareholders carefully. You only want shareholders who understand the risks and rewards attached to share holdings.

Conclusions

I hope that you find my tips useful as you grow your new business in these difficult times. If you would like to discuss how any of these could be implemented in your business please contact abacus accountants and business advisors at abacus59@abacusaccountants.co.uk or call Bode on 01708750640 / 08440502251. I will be delighted to hear from you.

Best of luck with your start-up from us all at **abacus 59**!

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Bode is the CEO and founder of **abacus 59 Limited** a firm of Independent Certified Practicing Accountants & Business

Advisors. Over the past 25 years, Bode has established a reputation as an SME accounting, tax and profit improvement expert. He has helped hundreds of small, medium and large business across Europe, Africa and the Middle East, to grow their sales, maximise profits and minimise their tax bills

He earned a Bsc (hons) degree in accounting from University of Lagos in 1981 after which he trained as a Chartered accountant with KPMG Peat Marwick in the West African region. He later earned an MBA from University of Leicester (UK) and attended the executive management program at the University of Notre Dame (USA). Bode is a Fellow of many professional bodies including the Institute of Financial Accountants (FFA), Institute of Public Accountants (FIPA) ,the Federation of Tax Advisers (FTA) , Institute of Chartered Accountants in Nigeria (FCA) and the ICPA.

He is married with two children, is a keen golfer and enjoys cricket and Jazz music.

Bode currently works mainly with Small and medium enterprises (SME's) in the UK that are, looking for ways to improve their revenue and profits, minimise their tax bills and stay fully compliant with tax and accounting regulations. He is an adviser to the boards of various businesses and charities, worldwide.

About Abacus 59

Abacus 59 is a member firm of the UK nationwide **abacus** network of accountants and consultants, the largest UK network of qualified accountants and financial management specialists, focused on providing services to small and medium enterprises (SME's).