Craft Brewery Finance

Financial Intelligence Brewed Daily

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3 Common Balance Sheet Mistakes + How to Avoid Them

The three common balance sheet mistakes occur in Pre-paid Expenses, Inventory and Accounts Receivable.

Let's simplify what each of these accounts and the problems that occur in each.

Pre-paid expenses are payments for things you'll get in the future. Pre-paid hop contracts is a good example. You pay now and expect to receive the hops later. Often, the payment is made and "pre-paid" is recorded, but never removed from the balance sheet. When the problem is discovered, it usually means a big hit to income statement expense.

Inventory is well understood as your raw materials, work-in-process (beer in process), and finished goods. However, pallets and kegs are part of inventory, too. These often forgotten assets go missing, and eventually lead to a big write off. The write of is recorded as an expense, and another hit to the bottom line.

Accounts receivable (A/R) is uncollected cash from your accounts. When you make a sale, but haven't yet collected the cash, a receivable gets recorded. Sometimes the customer never pays. These receivables accumulate and become bad debts. When bad debts are discovered and written off, they become another hit to the income statement in the form of bad debt expense.

The solution to these balance sheet problems is to reconcile the accounts each month. In other words, take a close look at the accounts and understand what it's in there. What you don't know, and don't question, will come back to bite you in the income statement.

How to Avoid These Three Mistakes: Reconcile the Accounts

A monthly balance sheet reconciliation sounds like a complicated process, but it's not. You simply need to look at the details that make up each account and determine if they make sense. For example:

Pre-paid expenses. Create a list of your pre-paid hop contracts and match it up (reconcile it) to the pre-paid amount on your balance sheet. Does it equal? If not, figure out why.

Inventory. Run a detailed inventory report and see how many pallets and kegs you should have. Count what you actually have and compare (reconcile) to the report. If there's a difference find out why.

Accounts receivable. Run a detailed aging report of your uncollected invoices. The 'aging' report will show the age of each invoice and how long it has been outstanding. If you have bad debts - invoices that will never be paid - it's time to clean up the listing and write off the receivables.

How to Avoid These Mistakes: Create a Balance Sheet Budget

You see a problem on your income statement when you have a budget to actual variance. For example, the sales are supposed to be $10,000 for the month, but they come in at $8,000. This 20% variance sticks out like a sore thumb. You recognize it's a problem and needs to be addressed.

Use this same approach with your balance sheet. One way to avoid costly balance sheet mistakes is to create a balance sheet budget.

Each line item on your balance sheet should have an expected balance. Any variance from the expected will show you there's a problem that needs to be dealt with.

Wrap Up + Action Items

Make the balance sheet a regular part of your monthly financial review. Question the balances - the assets and liabilities - and understand what the numbers represent.

Start with the three most common balance sheet mistakes: Pre-paid expenses, Inventory and Accrued Expenses. Fix any mistakes now before they become big financial surprises.

Create a budget for your balance sheet so that you can quickly see if there are 'variances' or balances that are different from what you expected. If variances do occur, ask more questions to determine if there are errors.

Now you know where to look and what to do to avoid these balance sheet mistakes. Grab your pencil, pull up a chair, and **give the balance sheet some love.**