NAHB Building Business Briefs

A Service of the Business Management & Information Technology Committee

Oil and Water: Don't Mix Personal Funds and Company Finances

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As a QuickBooks® ProAdvisor and construction accounting consultant, I've heard the following kinds of comments and questions from business owners:

> *"It's my company. I earn the money. I spend the money."*
>
> *It's all my money, isn't it? What's the difference whether I take personal money out of the company account, or pay money out of my personal account for the company?"*

There are two critical reasons why it's essential to track, record, and clearly identify any expenditures you make from personal funds on behalf of your company and all expenditures made from company funds on your behalf:

1. To accurately track your business income, expense, and job costs so that you receive and use accurate financial statements, operating results, and management reports each day.

2. So you don't lose out on (or double-count) tax deductions or under or over-report taxable income on your personal and business returns.

Recording Business and Personal Transactions

When recording financial transactions, your primary goal should be to report all company-related activities in company accounting records and to accurately identify and post company-funded personal transactions.

The easiest way to keep company and personal expenditures segregated is for you (the company owner) to:

1. Limit all personal financial transactions to personal accounts. For example:
   - Use your personal checking account to make personal purchases, car payments, home mortgage payments, etc.
   - Limit personal purchases on credit cards to personal cards.
   - Purchase personal vehicles and establish related loans in your own name.

2. Place company assets and liabilities in your business name and create business

transactions using your company name for the following situations:

- Business checking account
- Savings, money market, or investment accounts
- Company assets (e.g., land, vehicles, equipment)
- Company credit cards
- Loan accounts related to company purchases.

3. Take a regular paycheck and show it as a company expense (which you could record as reduce cash, increase expense). Or, if you receive draws (or distributions of income), you should assign the check to an equity account as a reduction of equity, so that it does not reduce your income (which you could record as reduce cash, reduce equity).

Although the preceding scenario is the ideal situation, I often encounter owners who regularly co-mingle their business and personal funds. The resulting accounting challenge, then, is to clearly identify and correctly record personal transactions.

The best way to approach recording a personal transaction is to first understand the specific circumstances surrounding it so that you can then properly record it. Here are some examples of personal transactions and notes regarding how they could be recorded in your accounting system. You, the owner, contribute something of value to the company. For example:

Owner's contribution	Could be recorded as
You make a permanent contribution to the company	Increase cash, increase capital contribution [equity] account
You contribute fixed assets, such as new or used office equipment, vehicles, or land	Increase asset accounts, increase capital contribution [equity] or loan due to owner [short-term or long-term liability]
You make a temporary loan to the company, such as purchasing goods or services out-of-pocket using cash, personal check, or personal credit card	Increase expense, increase reimbursements due to owner [short-term liability]
You make a long-term loan to the company. This should be documented with a formal note including interest rate, term of loan, and re-payment requirements **Note:** When you are repaid for short or long-term loans you have made to the company	Increase cash, increase loan due to owner [long-term liability] Decrease cash, decrease loan due to owner [liability]
You "contribute" personal credit cards for company-only use	When you place company purchases on the card, record them as increase owner credit card liability, increase expense. **Note:** Interest charges on these accounts used only for business are tax deductible.

The company contributes funds to you or pays out funds on your behalf. For example:

Company's contribution	Could be recorded as
You receive a draw or distribution of income	Reduce cash, reduce equity (depending on type of company) as follows: • Draw (sole proprietor) • Distribution (sub S corporation, LLC, or partnership) • Dividend (C corporation)
The company pays your (or your family's) personal expenses	Decrease cash, and increase loan due from owner [current asset] or reduce equity as shown above
You receive a temporary short-term loan from the company	Decrease cash, increase loan due from owner [current asset]
You receive a long-term loan (should also be formally documented)	Decrease cash, increase loan due from owner [other asset]

If you're not sure about how to identify or record a personal transaction, ask yourself questions and/or try to find original paperwork for individual transactions to determine underlying circumstances. For example, try to determine:

- Who initially owned the asset or liability, and who currently owns it—the company or the owner?
- Why are you are receiving the incoming funds—from work performed, or as a loan from the owner?
- Who received benefit from the expenditure—the owner or the company?

If you still don't know how to record the transaction, do the following:

- Place incoming funds in an account called "unclassified income"
- Place outgoing funds in an account called "unclassified expense"
- Contact your accountant for advice about how to record the transaction

Keep 'Em Straight

Taking the time to investigate, understand, and properly record transactions as they occur throughout the year will save your tax accountant considerable time and frustration at year-end. But, more importantly, it will especially pay off for *you* as you access your daily accounting and operating data. You will receive far more benefits from those "oil and water" (company and personal) transactions when they are recorded correctly and you can easily identify them in your current financial reports.

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