

Maintaining Good Financial Books and Records



By Brian Madigan LL.B.

If you are in business you should keep good financial records. It just makes sense, but so many small businesses neglect this tedious and somewhat time-consuming task. Careful records take time. And, if you don't really have the time yourself then you should retain a bookkeeper and an accountant.

Why? It will simply pay big dividends in the future. I'm not really talking about all the tax deductions that you don't miss because you have proper receipts, or even the warranty claims that you can present because (again) you have receipts. What I'm talking about is much more significant.

It's the sale of the business, the accumulated wealth of your lifetime of work. Is there any value to it? What is your business really worth? Who will buy it? And, most importantly, what will they pay for it.

In most industries, there is some kind of a "rule of thumb". Businesses are worth a certain multiple of their net profits. Oftentimes, this ranges from three to seven times the net profits. But, how are you going to prove your "net profits" if you don't have good financial records. They need to demonstrate some stability. Basically, that means at least three solid years. Also, they should illustrate increasing profits. The more you pay in income tax the better. If you're generating profits and paying income tax and GST, then this must be a worthwhile business.

The *Real Estate and Business Brokers Act* calls for the production of financial statements in all cases. However, there is a specific exception under the Act. If the purchaser agrees, the vendor can simply provide a list of assets (equipment and chattels) included, and another that sets out what is excluded, as well as particulars of the possession or occupation of the business premises. Far too many vendors take advantage of this opportunity. The problem is that they often only receive a tenth of the true value of the businesses (or even less).

If you are planning to sell your business in the next three years, the first item on the agenda should be to retain an accountant. The second item should be to drive the net profits as high as possible and in fact pay a significant amount of income tax.

A business generating \$100,000/year in profits from an industry that sells for seven times earnings would be worth \$700,000. Without proper financial records, this same business will likely sell for less than one year's profits or the value of its assets (chattels and equipment). The difference is substantial in all cases. Purchasers will pay for good businesses with well-documented financial statements.

So, keep excellent records, if not for yourself, for your purchaser!

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