

Clean Records

By Greg Wolf

Many family-owned businesses find it challenging to keep family and business finances separate. Larger businesses that operate as separate business entities do a better job of this, but even then do not always avoid mixing the two. This creates a range of problems, including frustration and stress, improper tax and financial reporting, and the inability to properly react to reports. Muddled financial records lead to a muddled focus, muddled reporting, and muddled decisions.

Consider John, the owner of a small appliance store which he operates in a renovated farm building on his property. He manages the store while his wife Susie does the bookkeeping. John also has two employees who work in sales and service.

Tuesdays are busy days. Store hours are longer, and it's Susie's day for bookwork. At 6:00 pm when the store closes, John and Susie review the bookwork and then go to the house for supper. Since Susie was working most of the day, she is always happy when John grabs some cash from the register to order in pizza or take the family out for supper. The cash is certainly not as much as Susie should get paid for her time, John reasons, as he freely takes whatever is needed for Tuesday supper.

As time goes on, and the business grows, John finds himself using cash from the business more and more. The children are getting older and a big help in the store. John feels justified buying a new bike for his 12-year-old son and a sewing machine for his 14-year-old daughter, paid for out of the cash drawer. After all, they are big helpers. Susie

is now in the store on Thursday as well, and the Tuesday supper tradition has also been adopted for Thursdays. Business is good, and life is good for John and Susie.

Fast forward the story five years. John's son and daughter are ready to become full-time

employees of the business. John's daughter can replace Susie in bookkeeping, while his son is ready to work in the repair department. But John has a few problems.

First of all, he doesn't know how to value the bookkeeping role. Susie never tracked her hours spent on bookwork and never got paid except for the tradeoff of cash from the store register to pay for supper. How much time should it take his daughter, and how much should she be paid as she takes up this role? John has no idea.

Secondly, John had never paid his son until now, although he knows he paid for a lot of nice things for his son out of the store's cash register. It always motivated his

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son to work when he saw the fruit of his labor come out of the cash register to fund his next desire. How much time and pay can John promise his son? He has no idea how to value his son's labor because he never tracked his time and "pay" in the past.

John is a good businessman, but a poor recordkeeper. He has failed to observe some basic principles of finance in relation to his business and personal finances. He wanted his children to become part of the business and enjoy the work, but his sloppy recordkeeping almost prevented it. As John discussed and reviewed a plan to bring his children into the business, it became apparent that this habit of robbing the register would need to stop. John's muddled finances never allowed him to know how much the business actually made and how much the family actually spent. This needed to change in order for John to give an honest paycheck to his children, be honest in accounting of taxes, and to develop a disciplined family budget. With no way to predict his children's value to the business, John had to pay them less than the going wage until the recordkeeping was clear. He hoped they would not move on to other jobs before he could pay them their worth.

While a family-owned business is often a valuable and intentional extension of family life, there needs to be a mental wall between the two entities. This is necessary for proper stewardship in both realms as we diligently manage God-given resources.¹ Maintaining this wall of distinction should not be regarded as burdensome, but rather helpful in maintaining proper focus and management in each realm. Each has their unique God-ordained roles.

Practical ways to keep things clear

Let's consider some specific practices that keep things clear between family and business finances.

¹ Proverbs 12:24 "The hand of the diligent shall bear rule: but the slothful shall be under tribute."

1) Separate the two

Take steps toward a tangible separation between personal and business finances. Open separate checking accounts. Keep separate accounting systems, budgeting processes, and financial reports. Use only business collateral for business loans and only personal collateral with personal loans.

For now, don't think about what the banker and the IRS man might expect. Instead, think about this tangible distinction purely for the sake of stewardship.

- **Checking** – Keeping track of whether it was Mom's grocery expenses or the boys' snacks at the shop is too hard when you use a single checking account for both business and the home. Separate checking accounts make it much easier. Separate accounts will track almost all the money that moves through the family or the business. It may be even easier if you use separate banks for the separate accounts.

Use separate cash accounts too. If all the cash from the home and business is mixed together in Dad's wallet or in one cash drawer or envelope, it's too hard to track. Separation is the key theme here. Separate the flows of cash into

distinct streams that can be accounted for and managed separately.

- **Accounting** – This involves keeping a separate set of books to track and summarize the flows of cash through the family finances as well as the business. You will likely need a different kind of accounting system for the family than you do for the business. Different systems will help to maintain clarity between the two.

In our small family business that operates as a sole proprietorship, I use QuickBooks for business accounting and an older version of Quicken for the family accounts. You don't need computerized accounting systems. Effective bookkeeping systems for both family and business accounting

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are available, including the One-Write system. But systematic separation of the two is the key.

- **Budgeting** – Once accounts and their accounting are separated, there is a more clear basis for budgeting in each realm. Budgeting is simply another way of thinking ahead and planning potential outcomes in an uncertain future. Budgets are important because they put on paper the planning that is likely already occurring in your head and shows your priorities. Writing down a plan for your money is a way to help you think through how you will use your money and communicate your plan to others. Having a budget and following it also gives accountability for where your money is actually going. Make sure the books are open to partners or your spouse so they can see that income, expenses, and giving are according to the budget. It provides a means of leading and following in family and business finances.
- **Reports** – Reports range from simple summaries of family spending categories to business balance sheets, profit & loss statements, and cash flow statements. The important point here is that they should be distinctly separate. There is no other way to properly tell whether a business is making money, which is a key part of family income. And there is no other way to fairly look at family spending, which is a key part of household stewardship. The recordkeeping of a family that has a business should be similar to a family that does not have a business, and separation in reporting allows for that.
- **Loans** – Banks often view family and small business finances as commingled in terms of loans and collateral, especially those without a distinct business entity involved. Family and other “angel” lenders are even more likely to view it like this. Neverthe-

less, those managing the family as well as the business should maintain clarity for their own stewardship purposes. It is simply too easy, for example, to fund family needs – or wants – on a business line of credit. This makes it hard to know what’s happening within the family and the business and to make wise and prudent management decisions.

2) Be an Employee

How family members in a family-owned business get paid depends on the type of entity and the advice of tax accountants. They may receive W-2 wages just as if they worked for some other business. Or they may receive 1099 wages or simply take owner draws of net income (as part of the owner’s business equity). Regardless, the point is that how they are compensated should be systematic and distinct.

It is a good idea to set up specific time periods for getting compensation, much the same as employees in other businesses would have. This allows both the business and the family to budget accordingly, so they don’t have to presume upon each other to keep cash flows positive. This is especially important with businesses in which income varies a lot. This method requires

discipline, but it is a necessary part of stewardship decision-making. Not having regular, set times for payments only muddies the waters and encourages unwise financial choices.

Family members should have the same expectations, responsibilities, and accountability as if they were employed elsewhere. This goes beyond the realm of finance, but it’s worth mentioning here, because it relates to compensation.

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3) Be a Customer

This is important when the family-owned business involves retail. It’s easy to use business resources for the family, assuming it’s all commonly owned anyway. But remember the wall that exists between the family and the business.

My family business is in food retail. Opportunities are

abundant to grab food out of the store for home use. This is not something to feel guilty about or even discourage, yet it should be done as though we are customers, with proper accounting. Family discounts are not necessarily wrong, especially when food is out of date or not selling. But failing to account for these purchases only muddies the waters of business profitability and family spending. It is also tempting to avoid our responsibility to pay sales tax, violating the command in Romans 13:6-7 to “render therefore to all their dues.”²

4) Be a Landlord

It might sound overly formal for a family owning a business to be a landlord. This means the business should compensate the family for any family assets used by the business. That often includes real estate assets but can also include such assets as equipment and vehicles, if they are not owned by the business.

In our business we have a small trailer for things such as picking up pallets of flour for our bakery. But we pull the trailer with our family vehicle. We used to try to guesstimate the miles used for tax information. But a couple years ago, we started reimbursing our family for the use of the vehicle each time the store uses it, using the IRS mileage rate. This has worked very well for us, placing a fair burden on the business for the use of that vehicle while relieving the family expenses associated with keeping that vehicle on the road.

² Romans 13:6-7 “For this cause pay ye tribute also: for they are God’s ministers, attending continually upon this very thing. Render therefore to all their dues: tribute to whom tribute is due; custom to whom custom; fear to whom fear; honor to whom honor.”

5) Balance Priorities

Even with our best efforts to maintain clarity between family and business finances, there are still some gray areas. For example, how much should the family be compensated by the business? It may be appropriate to pull all the family income out of the business, but it may be wiser to seek alternative income for the family until the business strengthens and grows. This might be a part-time job to allow cash and equity to grow inside the business.

In the early years of a family business, a family may find it helpful to prioritize family budget categories. They may want to use income from the business for more fundamental requirements such as housing, food, and clothing but hold off on categories such as recreation, travel, and a non-mandatory vehicle replacement. These categories are not necessarily wrong, but funding could come from somewhere else, until there is more income within the business to support them.

This illustrates once again the importance of planning and budgeting in both family and business realms, acknowledging that there is a balance between the two that requires some adjusting of priorities over time. It also shows the importance of maintaining discipline in managing finances, both in family and business, to make consistent stewardship choices.

Families with businesses are often tempted to muddle the ownership and management of the two, assuming they both belong together anyway. But to lose a sense of clarity causes confusion, misleads decisions, and hinders stewardship. It is important to develop a proper attitude of clear separation between the family and the business, implementing practices that will maintain that separation over time and believing this is best for the family as it seeks to wisely steward in each respective realm.



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