The 6 most common payroll mistakes

(and how to avoid them)

Hi!

Running your business is a lot of work. The last thing you want to worry about is a costly mistake from an accounting or payroll related misstep. This is important because with all the complicated rules and regulations, a lot can go wrong.

We worked with leading accounting software provider FreshBooks and identified the six most common accounting and payroll mistakes that can cost your business.

Knowing where the pitfalls are is just the first step. In this guide, we'll also provide you solutions and best practices so your business won't fall into those traps.

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How do you maximize your tax deduction and minimize tax exposure?

A common mistake for most small business owners is the mismanagement of expense tracking, particularly when it comes to receipts. How often do you find yourself asking:

> I'll take care of these receipts when I prepare my tax return.

Unfortunately, this is a common mistake made by novice and seasoned entrepreneurs alike. Receipts can become faded and unclear, or even worse, lost.

The impact on your business can be very meaningful, particularly around tax time. Without proper expense management, you may miss expenses on your tax return, which means fewer deductions. You may also mis-categorize an expense because the receipt is unclear, and end up triggering an audit.

Even if you're confident you're safe on taxes, poor expense management means you have poor insight into your company's spending. Rather than wait until tax day to organize your expenses, you should consider tracking them as close to real-time as possible to better manage your company's day-to-day operations.

Consider using an automated service provider to track your expenses as they come in. With a provider like FreshBooks, for example, you can import prior expenses from your credit card or bank accounts.

Customer story

Your business requires a lot of travel and you take taxis frequently. Rather than wait until tax time to see the impact of your travel expenses, use an online accounting vendor. This way, you can sync your expenses to your reporting software and track your expenses in real time.

02

How frequently should you pay and file taxes to avoid tax penalties?

As an entrepreneur, taxes are probably the last thing on your mind until April. You may think:

> I'll reconcile my tax payments at the end of the year.

But it turns out you may have to pay payroll-related taxes year-round. The IRS and each state regulate your tax payment schedule, and the schedule differs between each state. The frequency of your tax payments also depends on your payroll frequency (e.g., monthly, biweekly). 40% of small businesses get fined an average of $850 per year for improperly paying their payroll-related taxes so this is not a small concern.

It's important to pay attention to IRS and state notices mailed to you year-round. Each state has its own set of regulatory bodies for payroll tax compliance.

On the following pages is the complete list of state governing bodies for labor and payroll:

Customer story

Your business pays monthly payroll for most of your employees and semimonthly for others. Rather than pay taxes according to the employee's pay period, you pay taxes monthly for everyone. Because you are not matching your taxes based on pay period, you may be at risk for tax penalties. To protect your business, outsource your payroll to a third-party provider.

ALABAMA
- Dept. of Labor
- Dept. of Revenue

ALASKA
- Dept. of Labor and Workforce Development
- Dept. of Revenue

ARIZONA
- Dept. of Economic Security
- Dept. of Revenue

ARKANSAS
- Dept. of Finance and Administration
- Dept. of Workforce Services

CALIFORNIA
- Dept. of Industrial Relations
- Employment Development Dept.
- Franchise Tax Board

COLORADO
- Dept. of Labor and Employment
- Dept. of Revenue

CONNECTICUT
- Dept. of Labor
- Dept. of Revenue Services

DELAWARE
- Division of Revenue
- Dept. of Labor

DISTRICT OF COLUMBIA
- Dept. of Employment Services
- Office of Tax and Revenue

FLORIDA
- Dept. of Economic Opportunity
- Dept. of Revenue

GEORGIA
- Dept. of Labor
- Dept. of Revenue

HAWAII
- Dept. of Labor and Industrial Relations
- Dept. of Taxation

IDAHO
- Dept. of Labor
- State Tax Commission

ILLINOIS
- Dept. of Employment Security
- Dept. of Revenue

IOWA
- Dept. of Revenue
- Workforce Development

KANSAS
- Dept. of Labor
- Dept. of Revenue

KENTUCKY
- Career Center
- Dept. of Revenue

LOUISIANA
- Dept. of Revenue
- Workforce Commission

MAINE
- Dept. of Labor
- Revenue Services

MARYLAND
- Dept. of Labor Licensing & Regulations
- Comptroller of MD

MASSACHUSETTS
- Dept. of Revenue
- Labor and Workforce Dev.

MICHIGAN
- Dept. of Licensing and Regulatory Affairs
- Dept. of Treasury

MINNESOTA
- Dept. of Employment and Economic Development
- Dept. of Revenue

MISSISSIPPI
- Dept. of Employment Security
- Dept. of Revenue

MISSOURI
- Dept. of Labor
- Dept. of Revenue

MONTANA
- Dept. of Labor and Industry
- Dept. of Revenue

NEBRASKA
- Dept. of Labor
- Dept. of Revenue

NEVADA
- Dept. of Employment, Training and Rehabilitation
- Dept. of Taxation

NEW HAMPSHIRE
- Dept. of Labor
- Employment Security

NEW JERSEY
- Dept. of Labor and Workforce Development
- Division of Taxation

NEW MEXICO
- Dept. of Workforce Solutions
- Taxation and Revenue Dept.

NEW YORK
- Dept. of Labor
- Dept. of Taxation and Finance

NORTH CAROLINA
- Dept. of Labor
- Dept. of Revenue

NORTH DAKOTA
- Dept. of Labor and Human Rights
- State Tax Commission

OHIO
- Dept. of Job and Family Services
- Dept. of Taxation

OKLAHOMA
- Employment Security Commission
- Tax Commission

OREGON
- Employment Dept.
- Dept. of Revenue

PENNSYLVANIA
- Dept. of Labor and Industry
- Dept. of Revenue

RHODE ISLAND
- Dept. of Labor and Training
- Division of Taxation

SOUTH CAROLINA
- Dept. of Employment and Workforce
- Dept. of Revenue

SOUTH DAKOTA
- Dept. of Labor and Regulations

TENNESSEE
- Labor and Workforce Dev.

TEXAS
- Workforce Commission

UTAH
- Dept. of Workforce Services
- State Tax Commission

VERMONT
- Dept. of Labor
- Dept. of Taxes

VIRGINIA
- Dept. of Taxes
- Dept. of Labor

WASHINGTON
- Dept. of Labor and Industries

WASHINGTON DC
- State Tax Dept.
- Workforce West Virginia

WEST VIRGINIA
- Dept. of Workforce Department
- Dept. of Revenue

WISCONSIN
- Dept. of Workforce Services

With all these state regulations, it may be a challenge to stay compliant. Fortunately, a full-service payroll provider like Gusto should manage these tax payments so you don't have to.

03

How do you manage receivables to get cash back into your business?

As a business operator, you may be too busy selling your product and forget about collecting on your receivables. It's easy to just think:

> If I just focus on getting customers and delivering good service, my business will succeed.

But a lengthy **Days Sales Outstanding (DSO)** means you're extending a lot of credit to your customers and not collecting cash quickly enough. This means you're leaving your balance sheet exposed to cash shortfalls. In addition, invoices can come at an unpredictable rate. If you're not matching your revenue with your expenses as they come, you can hit **working capital** issues.

Without proper invoicing, your business is open to costly mistakes. For example, you may invoice your customer the wrong amount. Or you may forget to bill them entirely!

To protect yourself from cash shortfalls due to poor invoicing, consider using an online vendor to automate the process. A vendor can help you:

- Invoice as soon as the project is finished
- Track the work throughout the engagement
- Automate follow-ups, especially if payments are late
- Accept payments online
- Create an online paper trail for clients and regulators

Customer story

Your business provides a minor service for a customer and you send an invoice shortly after. Because you did not have any systems in place to remind yourself of the outstanding payment, you forget and you don't collect.

04

Is accrual or cash accounting best for your business?

There are two types of accounting methods: cash and accrual accounting. You may wonder:

> My business is too small for my accounting methods to have any impact.

Actually, which method you choose can have a meaningful impact on visibility into your business operations. Your accounting method can provide direct insight into the financial health of your business and inaccurate accounting can lead to fines.

First, let's define the two methodologies:

Cash accounting: This type of accounting recognizes revenue when cash is received and expenses when cash is paid out. Under this method, there is no accounts receivable or payable.

Accrual accounting: This type of accounting recognizes revenue and expenses when they are earned, regardless of when cash is pa id in or out.

Customer story

Your business is growing quickly so you decide to hire a team member to build out your FP&A group. Since you're looking to project P&L, you decide to switch from cash accounting to accrual accounting.

Here is a breakdown of the pros and cons of these two methods across different criteria:.

	CASH BASED		ACCRUAL BASED	
VISIBILITY INTO CASH FLOW	HIGH	Ledgers correspond directly to cash on hand	LOW	Ledgers account for expenses or revenue not yet paid
VISIBILITY INTO LONG TERM TRENDS	LOW	Balances for a selective period can be biased by an influx of payments, regardless of when the sales were actually made	HIGH	Business owners can use trends to predict future costs and revenue
ACCOUNTING COMPLEXITY	LOW	Income and expenses are recorded in tandem with cash in/out	HIGH	Recorded income and expenses do not necessarily reflect cash on hand

Which method should you adopt? While most small businesses start with cash accounting, as companies grow, they adopt accrual accounting because it better monitors a company's long-term financial health. It also follows accounting's matching principle.

A wrong selection may cause a serious problem for your business. For example:

- Under accrual accounting, your business reports revenue before receiving actual payment, and you are short on cash this week or month.
- Under cash accounting, you don't have a clear view on your company's growth because you only report revenue when cash comes in. You end up under-investing in your fast growing business.

05

How do you avoid misclassifying employees and contractors?

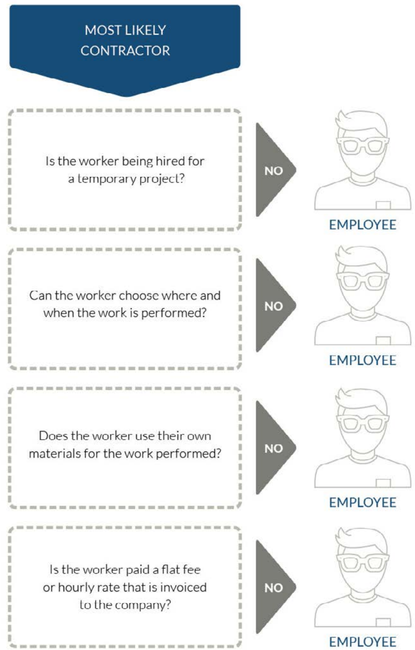
Using a contractor is a great way to bring additional help to your business. But are your properly classifying your worker? Do you catch yourself asking:

> I only use contractors infrequently so I shouldn't have to worry about the rules.

Misclassifying your worker can be a costly mistake on multiple fronts. If your contractor is actually an employee, you may be underpaying payroll taxes. On average, employees can cost 25-30% more than contractors.

In additional, nearly 30% of employees are misclassified as contractors. Your business could face serious legal and financial penalties as states and the federal government are cracking down on labor abuses.

Use this guide to check to see if your worker is a contractor or employee. (use same content as before)



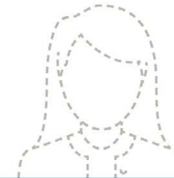
Customer story

Your company needs help so it hires a designer to work on some projects. This designer starts out working from home but as projects ramp up, you bring the designer into the office. The designer starts coming in for regular hours, and works on a laptop set-up used by other full-time employees. Your worker may now be an employee instead of a contractor.

Employee vs Contractor

Before you make this important staffing decision, you need to fully understand both types of workers and the importance of classifying them correctly. Failing to do so could cost your business.

If you are still unclear, complete IRS Form SS-8 and they'll give you a final determination of the worker's status. It could take 6 months for a decision, but it will give you peace of mind to continue running your business.



EMPLOYEE	VS	CONTRACTOR
Eligible for company-sponsored benefits like medical insurance, retirement planning, vacation days, fitness stipends, training, etc.	COMPANY BENEFITS	Needs to make their own arrangements for medical insurance, retirement planning; not eligible to participate in any company-sponsored benefits programs.
Eligible for unemployment benefits and state workers compensation.	GOVERNMENT BENEFITS	Generally not eligible for unemployment benefits or state workers compensation.
Has payroll local, state, and federal taxes withheld from their paychecks along with Social Security and Medicare deductions.	TAXES	Has no deductions withheld from their paycheck and needs to withhold quarterly taxes independently in order to avoid end of year penalties.
Could be eligible to receive overtime pay depending on the job function or hours worked.	OVERTIME PAY	Not eligible to receive overtime pay as outlined by the Department of Labor.

06

What payroll and accounting reports do you need to keep on file?

After avoiding all these potential mistakes, it's tempting to think you're done without proper reporting:

> I filed the proper forms, I'm done!

Actually, good reporting can help you manage your business or help you avoid costly legal fines. For payroll, you are legally obligated to keep certain documents on file:

Form I-9: Each employee needs to fill out Form **I-9** to verify he or she is legally eligible to work in the US. You don't need to submit the form, but you must keep it on file (a digital copy works just fine) for the entirety of the employee's employment, and a minimum of either 3 years from the hire date or 1 year from the term date, whichever is longer.

Optionally, you can choose to verify the employee's work status online using **e-Verify**.

Form W-4: Your employee will also need to fill out Form **W-4** to determine their tax withholding (Note: You cannot do this on their behalf). The W-4 does not need to be submitted anywhere, but each company is legally required to keep every employee's W-4 on file for a minimum of four years. Only modern payroll providers like Gusto manage your withholding taxes on behalf of you and your employee.

A withholding tax is a pay-as-you-go tax to the IRS and can be calculated through the W -4 and their **IRS withholding calculator**. These three things determine how much you withhold for your employee:

- Marital status
- The number of allowances claimed on the W-4
- Compensation (Note: This may depend on the State where your employee receives payroll.)

Employees who anticipate a full refund may be exempt from withholding. This is different from employees who are exempt, like clergy or certain visa holders.

New hire reporting for states: Each state has a department to report your new hires. You will typically provide the employee's name, address, and social security number. Depending on the state, you may have anywhere between a few days to 90 days to submit this information to the state. Check your local state tax, labor, and workforce website for more information. In California, for example, an employee has to file a **DE-34**. Fortunately, your payroll provider should be able to file documents like the DE-34 automatically on your behalf.

Reporting and metrics: In addition, good reporting can also give you visibility into your business finances. The metrics you want to track include:

- Which invoices are outstanding, and how old?
- How much have I spent, and on what?
- What work will I be able to bill for soon and for how much?

To monitor these metrics, create the following reports with modern accounting software like FreshBooks:

- **Accounts receivable aging**: This report helps categorize your accounts receivable based upon the length of time of the outstanding invoice.
- **Expense report**: It's important to have an itemized and categorized report of your expenses for both budgeting and tax reporting purposes.
- **Profit and loss (P&L)**: The P&L statement is a summary of your revenue, expenses, and profit over a period of time. It is sometimes called an income statement too.

Customer story

Your company has multiple clients and your collections team does not have a clear outlook on aging of certain invoices. Use a modern accounting software provider to monitor your accounts receivable aging and other important financial metrics.

Let us help you

Now that you identified these common accounting and payroll mistakes, it's important to work with SaaS partners like FreshBooks and Gusto who can handle these problems for you. With Gusto, we designed our software so that business owners are prevented from making mistakes when possible. This way, you don't have to worry about payroll and you can continue growing your business.

For more information on how Gusto can help you, check out the following resources:

- **Gusto blog**: This is our ongoing corporate blog that covers the latest small business best practices, updated multiple times a week.
- **Gusto FAQ**: We answer some of the most common questions about our payroll software and its features.
- **Gusto customers**: See what other Gusto customers are doing to grow their business.