BUSINESS
OWNERS
ACCOUNTING
TIPS

July 2026

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LOAN PAYMENTS . . . *done correctly*

When we think of loans, we think about how much debt we want to assume at what interest rate, e.g., Commercial loans in the range of 5.5% to 8.75%, bridge loans all the way to 12% plus, and prime lending at 6.75%.

Unfortunately, many small business owners are unaware of how to properly record paydowns in their books.

***So why is that an issue*?**
Because it could significantly affect your <u>reported</u> Revenues or Expenses.

TRUE STORY

The company borrowed $40,000 @ 14.5% from a 3rd-party transaction processor (e.g., PayPal, Stripe, Jobber), thus requiring $45,800 in paydowns.

Here are the entries they made:

- DR Bank Cash $40,000
- DR Loan Expense $5,800
- CR Loan Payable $40,000
- CR Loan Payable $5,800

1st problem – you can <u>only deduct the loan expense when the payment is made</u>, Thus, it should never be added to the loan liability

The loan payment was automatically deducted from the sales being processed via the 3rd party ***before*** the remaining proceeds were transferred to the company. Subsequently, the company received a statement of the net sales used to pay down the loan.

The Company recorded this as:

- DR Loan Payable
- CR Loan Payment (Current Liability account)

2nd problem – the net sales used were never recorded as Sales.

3rd problem – because the company used 2 liability accounts to record the payment, the liability never decreased.

TAX IMPACT

- Expenses were **overstated** by the amount of payments that would not be recorded until the future.
- Revenues were **understated** by the amount of sales used to pay the loan.

4th problem – tax, penalties, and interest are now due for the $40,000 of missed revenue; **probably ~$10,000**.

HOW SHOULD PAYMENTS BE RECORDED?

- DR Loan Payable (principal)
- DR Loan Expense (interest)
- CR Cash (in this case it should have been Sales)

Call us to discuss how we can be of assistance

If you are a startup, small business, or nonprofit, MyAdvisor LLC is here to help you with bookkeeping, accounting, and tax services at value-priced rates.

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