

BASICS OF BUSINESS

Accounting for Your Business

Good record keeping — a constant and detailed knowledge of expense, income, and profit or loss — is the first step toward profitable management of your business. Business owners should constantly keep an eye on the bottom line. Proper analysis of a small business' financials, enable its decision makers to identify:

Trends — predictable outcomes based on past performance

Areas for growth – new or existing revenue sources that might yield greater results through increased focus

Potential trouble spots – parts of the business costing too much money or time

Additionally, proper accounting is critical for smooth tax preparations and filings.

What Are the Basics of Small Business Accounting?

Small business accounting begins with careful attention to bookkeeping, which is the overall organization of financial transactions.

Record Keeping An owner must keep and utilize detailed records to successfully manage the business. Never rely on memory, close personal contact with the business or on some simple system you believe replaces basic records.

Make effective use of the records kept. Many owners fail to use inventory records for changes in buying or merchandising policies and charge account records for customer analysis and sales promotion. Without adequate records, it will be impossible for your business to effectively handle purchasing, inventory control, credit, collections, expense control, personnel, production control and other aspects of management. Experienced owners know it's common sense to keep accurate, written records of business transactions. Lack of proper records will prevent you from knowing how your business is doing; the first indication something is wrong may come too late. Records will help you prepare your income taxes and obtain loans. Records also aid in planning the future based on financial facts rather than guess work.

Trade associations often provide guidelines or accounting records tailored to a particular type of business. Also, a variety of records and record-keeping systems are available at bookstores. It is suggested that you use some type of computer-based program tailored to your needs. There are a number available on the market today combining accounting (accounts payable, receivable, and payroll) as well as word processing and data base functions.

Every business should have up-to-date accurate records providing the following:

- Sales and operating results
- Fixed and variable costs, profit or loss, inventory levels and credit and collection totals.
- Comparisons of anticipated with actual business performance.
- Financial statements, profit and loss, cash budget and balance sheet.
- Tax returns and reports to the government.

- A method for uncovering employee thefts, material waste, or record-keeping errors.

Your essential records should include the following information:

- Daily summary of cash receipts taken from cash register tapes, charge slips, and sales receipts.
- Expense ledger tallying both cash and checks for accounts payable, payroll, rent and other recurring expenses.
- Inventory system showing shipments received, accounts payable and the amount of inventory on hand.
- Employee record listing hours worked, pay and withholding deductions for both full-time and part-time employees.
- Accounts receivable record for credit sales.

Internal Revenue Service does not require specific accounting methods, records, or systems. It does require that you maintain permanent records clearly and accurately showing taxable income, expenses and other allowable deductions. These also must be kept for inspection at any time by IRS officers.

Hiring a Bookkeeper and an Accountant

You should hire both a competent bookkeeper and a professional accountant that are right for your needs. Obtain referrals from others in your type of business. SCORE, trade associations, management consultants, business associates and friends are also good referral sources. It's not necessary to have an accountant do your day-to-day bookkeeping, but your bookkeeper must have adequate experience and qualifications to handle your record keeping needs. It's also good to contract the services of a professional accountant to provide important advice and help determine what records to keep, the most economical way of maintaining the records, techniques to ensure against paying unnecessary taxes and the most efficient system of cash flow management. An accountant's advice is also helpful in keeping track of inventory, so you will always have enough on hand for customers, but not more than necessary. The accountant will also suggest methods for depreciating assets and maintaining current balance sheets and income statements.

Bookkeeping Basics

Bookkeeping focuses on all transactions, laying the foundation for analysis. By categorizing, organizing, tracking, recording, and balancing the information, your business is on its way to better understanding its financial health.

A bookkeeping checklist can provide the foundation for your accounting practices, and making sure you have the right bookkeeping services in place. One way to organize your checklist follows:

- Daily — Track cash on hand plus any incoming or outgoing transactions. Weekly
- Weekly — Record all billings and payments; update payroll

- Monthly — Balance accounts; review and process payroll; account for payroll taxes; review month-end balance sheet
- Quarterly — Review profit and loss projections; make quarterly payroll payments and tax payments
- Yearly — Analyze year-end inventory; complete IRS and tax forms; review year-end financials

Depending on size of the business and scope of work, a small business could benefit from a bookkeeper's services for 3-4 hours per month to organize all bank activity and reconcile the bank account. If bookkeeping needs are more advanced, it can have enough work for 10-15 hours per week. In such case, a bookkeeper could manage billing clients, writing vendor checks, preparing payroll, and preparing sales tax forms.

Basic Accounting Tools beyond Bookkeeping

Sound bookkeeping is the beginning of small business accounting. Some basic steps will ensure that small owners are equipped with the financial understanding of their companies, both today and future. Here are the steps of basic accounting

Establish a dedicated bank account.

By keeping your professional finances in a separate bank account, your monthly financial statements will require less manipulation, and your bookkeeping system will benefit. A business bank account will also protect the proprietor's finances through personal liability protection.

Determine your payment policies and terms.

Will you require payment up front? Who will do your invoicing? Will you accept credit cards? Will you pass sales tax along to the consumer, or will you cover it yourself? Having a sense of these answers help shape your accounting system and give you greater control. These are also questions you should answer before determining which accounting method you plan to implement.

Establish a methodology for recording sales.

Recording sales is about organization, bookkeeping, and basic accounting. Every sale has a paper trail, from a basic receipt to detailed information entered into your Customer Relationship Management (CRM) software. Your ability to retain customers or clients is tethered to knowing who they are and what kind of tendencies and history they have.

Your recorded sales information can then be collected in a ledger that holds all transaction information, helping you prepare income statements, gauge profitability, assist with inventory management if you are selling goods, and organize your financial information in advance of tax time.

Establish a system for recording revenues and expenses.

Both revenues and expenses need be tracked carefully, regardless of record-keeping practices. You can track income and expenses by hand or with the right software — or you can elect to hire an accounting professional such as an enrolled agent, a certified public accountant or a bookkeeper.

Understand cash flow.

Cash flow statements summarizing all money from all sources both received, owed, and dispensed, are an invaluable resource for business owners, they are the most concise and thorough analysis of financial health.

Cash flow is calculated one of two ways, by the direct or indirect method. The direct method focuses solely on net cash flow while indirect method considers non-cash revenue and expenses, such as purchases on credit.

Select an accounting method.

There are two ways of going about tracking and recording your finances, cash accounting and accrual accounting. The major difference comes is when you consider the money in or out of your possession.

Cash accounting records income and expenses only when the money is received or paid out. Payments owed both to and by your company will not be reflected in your account until the money exchanges hands. Cash accounting provides the most accurate appraisal of cash in hand for a small business, helping avoid cash-flow problems.

Accrual accounting tallies all debits and credits regardless of when financial transactions occur. Typically, this method is suggested for companies maintaining inventory. It provides for a clearer big-picture perspective.

Service-oriented businesses may opt for cash accounting, while businesses selling goods elect accrual accounting.

Small businesses opting for accrual accounting do need to remember they may have to pay taxes on reported income not yet received. Additionally, those businesses can claim expenses for tax purposes before money has left the company. This's where the right accounting software or accountant is critical.

Bringing in an Accounting Professional for Your Business

Your need for an accountant may not depend solely on your comfort with financial information. At a certain point, you will need to spend more time on other areas of your business—elements only you are qualified to handle. Your time is money, at a certain point you may find your time is better spent in areas other than bookkeeping and tax reporting.

Rather than waiting for tax season, you can bring an accounting professional on board earlier in the process of establishing your business. An accountant can make sure you're in compliance with a variety of regulations. Don't wait for an audit from the IRS to call for help.

For companies using a bookkeeper and having their finances in order, an Enrolled Agent or a CPA would only be needed for tax preparation. Organizing your transactions will lower the cost

needed to sort through a year's worth of bank transactions. A startup might want to consider an introductory consultation from an accountant to better understand overall needs.

For business owners looking to take on more accounting responsibilities, there's accounting software. Software packages provide different capabilities. Do your research and talk to other business owners before choosing your software.