

MANAGING YOUR MONEY

BUDGET, DON'T FUDGE IT!



“Money is a good servant, but a bad master.

—Aristodemus

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What's This Session All About?

This session will discuss how to develop a mindset for business success. Doing so will help you prepare for the tasks of accounting, recordkeeping, and managing money. Then, to help you with these tasks, several types of accounting systems will

be presented and discussed. The session ends with a discussion of the professionals who can assist you with accounting and tax chores.

Preparing for success. This part of the session deals with preparing yourself mentally to manage the money flowing through your business—both the money that comes in, and the money that goes

out. It's not enough to watch it come and go! You have to control it—both by keeping it separate from your personal funds, and by developing firm ethical guidelines for handling money and business-related issues.

Accounting. Why do you need to keep books and records? First, there are legal requirements. The federal government

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demands that you maintain records to support the amounts entered on your tax return. Second, bankers and lenders require you to keep records. Last, accounting is how you gather the information you need to run your business.

Business ownership and tax forms. The choice you make for your business entity will impact the way the IRS and your state tax agency treat you and your company. In this part of the session, you will learn about the basic tax forms required for four common business structures.

Getting professional help. How do you know the right way to set up your recordkeeping and bookkeeping system? This section discusses the resources available to help you make those kinds of decisions.



Preparing for Success

To position yourself and your business for success, you must develop a professional attitude about business. You also need a clear idea of what success means to you. You can't achieve a goal until you can picture that goal clearly.

Some people think of success only in financial terms. They might say, "I want to make lots of money," or "I want to invent something I can sell for thousands of dollars." Such goals are neither realistic nor clear, and this makes them hard to achieve. If you set goals like these for yourself, you're likely to become discouraged when you do not reach them.

Instead, you should set realistic dollar goals for your business. For instance, your first-year goal might be: "I'm going to break even this year and cover my costs." That may not sound like an achievement, but it is. Many businesses don't make a profit during their first year!

Once you've met or exceeded your first-year goal, you can shoot for a larger profit in the next year.

That fact is, it often takes two years just to work out the kinks in a business. It takes time to refine and improve products, test theories, set up efficient office systems and procedures, locate suppliers, and locate customers. By the third year, things will begin to fall into place.

It's also important to understand that there are other valuable goals beyond making money. A "profitable" year might be one in which you gained:

- Valuable business contacts
- Knowledge and experience
- A new understanding of your strengths and weaknesses
- A new marketing channel that will pay off the following year

Even a failed part-time business can be profitable, if it points the way to a better idea that *will* work. Or it may reveal something important in your character that encourages you to go in a new direction. Again, failure has its redeeming qualities, and you will always learn something from it.

Going Legit

Many microbusinesses illegally operate off the books. This is not only an unprofessional attitude; it's also a self-defeating trap. No business can grow if it remains hidden. It needs visibility to survive and prosper!

Why should you be legal, especially when so many other people are getting away with running a business off the books? You may think the chances are pretty good you won't get caught. But all the people who *have* gotten caught thought exactly the same thing, right up until it happened to them.

There are rewards for going legit, too. Self-employed individuals qualify for many breaks that can lower their taxes. Once you're in business, you'll find you're entitled to tax deductions that can save you money. In fact, in the early years of your business, it's possible that you'll end up with a business loss, at least on paper, which can reduce your taxes (or even earn you a refund!).

Once you're up and running, it won't seem at all unusual to the IRS if you need to buy office equipment, a computer, or a car to advance your business. A large percentage of such costs can immediately be offset against receipts or written off (depreciated) over a specified number of years.

Why hide your income when you can have legal tax deductions? Besides, if you're trying to prove your creditworthiness—to get a business loan or a home mortgage—you'll want your gross income and net profit to be as high as possible.

Last, don't underestimate the tremendous feeling of satisfaction that comes from playing by the rules, and winning! It'll be a source of pride for you, and serve as an inspiration to others.

Separating Personal and Business Accounts

One of the things you must learn to do is keep your own finances completely separate from those of your business. Let's say you buy a computer for personal use. Even if you used business funds for that purchase, the computer does not belong in the business's financial statements. By the same token, you should always keep your personal records separate from your business records.

Business Ethics

Entrepreneurs face many ethical tests as they struggle to get their businesses off the ground, and most of them have to do with money. They may be tempted to hide their income from the govern-

ment, issue misleading advertisements to earn more sales, or engage in dishonest selling practices.

Although many of these actions are illegal, business ethics go beyond what is legal or illegal. Ultimately, a business has the same responsibility to be honest, fair, and socially responsible that an individual does.

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I'd been living on the Mainland for twelve years. Originally, I went over to visit a friend in Iowa City. I found it hard to leave again, and for a long time I was kind of stuck there. It's a long story. The simplest way to put it is, I made some bad decisions.

When my Dad died, I came back home to look after Mom. She was sick too, and I knew it was time to grow up and do the right thing by her. Guam's economy wasn't too good, though. Unemployment was high. I didn't know how I was going to support both of us.

I got some books and started to read about how to start a business. I learned some stuff, but it wasn't much help since I didn't have any idea what my business was. And to be honest, it also didn't help that I'd always been lousy with money. I'd spent almost all my savings on the Mainland, and had nothing much to show for it.

When Jimmy Cruz moved back to Guam, his situation wasn't promising. The most common businesses didn't appeal to him much, not least because most of them paid only minimum wage. He wasn't looking to sell handicrafts at flea markets or roadside stands, or wait tables in chain restaurants. He didn't want to change sheets in tourist hotels, or set traps for boonie dogs. And he *definitely* didn't want to climb telephone and power poles to unwind brown tree snakes from the wires, no matter how steady the work was!

He'd been a handyman in Iowa City, and had also worked for a water purification firm. There had to be something he could do with

those skills that would support him and his mom. But he couldn't imagine what.

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Defining values

Most experts agree that ethical people have these traits in common:

- Fairness
- Fidelity
- Honesty
- Integrity
- Respect for others
- Good citizenship

You probably look for these qualities in yourself and others, so it's only natural that you should want to run a business that reflects those same values! That means choosing the right over the wrong, and the fair over the unfair.

That's not always easy. Sometimes, it seems like we'll have to compromise one or more of our values, no matter what. When this happens, we find ourselves in an ethical dilemma.

People compromise their ethics for many reasons, including financial worries, peer pressure, and deadlines. When you're operating under stresses like these, it's important to ask yourself the following "mirror test" questions:

- Does the decision make you feel guilty, disappointed in yourself, or anxious about what someone else might think?
- If a child, spouse, or friend were in a similar situation and came to you for advice, would you recommend the same course of action you're choosing?
- Would you feel comfortable if your decision received public scrutiny or media attention?

- If someone did something bad to you and used your excuse, would you accept it?

These questions can help you pinpoint ethical dilemmas, look at them without illusions, and resolve them. One of the hardest tasks in ethical decision-making is to be able to see a problem from someone else's point of view; always ask yourself how you'd want to be treated if you were in the other person's shoes.

Treating customers ethically

Customer loyalty is the result of trust, and trust is the result of fair dealing. A customer considers a transaction to be fair when it satisfies his or her expectations (i.e., an excellent product, delivered on time, at a reasonable price).

When conflicts or disagreements arise, you should try to see things from the customer's point of view, and bend over backwards to reach a fair agreement. This will distinguish you from your competitors, and give you a competitive advantage. Don't focus too much on money; it costs more to get new customers than to keep old ones happy. As we learned in Session 11, a situation in which you lose a little money, but earn a loyal customer, is a win-win situation.

Accounting

Accounting means tracking and recording your business's income and expenses. Many people put off learning about it for as long as they can. That's understandable. At times, it can seem overwhelming! But if your business is to be successful, you'll need a system for creating and maintaining business records.

Most new business owners think they must keep records so they can figure out what they owe the Internal Revenue Service. It's true that the IRS requires every business to keep track of income and expenses, and to keep documents that sup-



port the numbers on their income tax return. But an even better reason to keep records is that you need this information to run your business from day to day!

It can also help you understand how to make your business run better from one year to the next. For instance, it lets you make financial forecasts, and then track the business's actual performance. This way, you can see what you thought was going to happen, and compare it to what actually happened. You can compare this month to last month, or this year to last year. What did you do right? What did you do wrong? How can you improve?

An accounting system used in this way doesn't only help you make intelligent and informed decisions about your business. It can actually be fun, too!

Cash or Accrual?

The first step in organizing the financial side of your business is to choose a bookkeeping method. There are two primary methods for small business owners—cash and accrual.

- Under the **accrual method**, revenues and expenses are reported when they occur, regardless of whether any cash has changed hands. In other words, if you do a job in January, and you get paid in March, you report that income for January.
- The **cash method** calls for reporting revenue when cash comes in, and expense when cash goes out. So if you do a job in January and get paid in March, you report the revenue in March.

Many accountants prefer the accrual method. But it's a bit more difficult, which is why many small businesses prefer the cash method.

Some businesses are required by federal income tax rules or bank loan agreements to use the accrual method. If you're not sure whether to use cash or accrual, get professional advice.

Calendar Year or Fiscal Year?

You must also select an accounting year for the business. It's most common to use a calendar year, but other dates may be more appropriate for your business. An accounting year that ends on a date other than December 31 is usually referred to as a **fiscal year**. Some businesses choose a fiscal year when their business is seasonal, or to gain income tax advantages. This is a good point to discuss with your adviser.

Debits and Credits

Suppose you have a clean sheet of paper for each of your assets and liabilities, as well as your owner's equity, revenue, and expense accounts. Take one of these pages, and draw a vertical line down the middle, dividing it in half.

Now, you can record increases to that account on one half of the paper, and decreases on the other. At the end of a given period, you can total both sides and see what changes occurred. Doing these increases and decreases in the following manner results in another accuracy check.

Assets	
+	-

Liabilities	
-	+

Owner's Equity	
-	+

See how the plus and minus are reversed on the two sides of the balance sheet? This way, when you record business transactions, your left sides will always equal your right sides. This is called **double-entry bookkeeping**; it's the foundation of accounting.

Suppose your business buys a new computer for \$2,000 on account. Your assets have increased, so \$2,000 goes on the left side of your *Computer* page. Your liabilities have increased because you owe \$2,000, so this amount goes on the right side of your *Accounts Payable* page.

General Types Of Accounting Records

General Records:

- Revenue (sales) journal
- Expense journal
- Petty cash record
- Inventory record
- Accounts Payable
- Accounts Receivable
- Fixed Asset/Equipment log
- Mileage/Travel log
- Payroll records
- Business checkbook
- Customer records
- Time sheets
- Employee records
- Other

Statements:

- Income Statement (P&L)
- Balance Sheet
- Cash Flow Statement

At this point, you've recorded \$2,000 on a left side and \$2,000 on a right side. After every transaction, you can check to see if your "lefts" equal your "rights." If not, you've made an error.

Instead of talking about lefts and rights, accountants call them **debits** and **credits**. Debit means the left side of the accounting sheet, and credit means the right side.

This system won't protect you against every type of error. For example, if you record your computer purchase with a debit to *Computer* for \$2,000 and a credit to *Accounts Payable* for \$200, this error will show up when you try to balance the books. However, if you mistakenly record a debit to *Computer* for \$200 and a credit to *Accounts Payable* for \$200, the system won't catch the error. The same holds true if you forget to record the transaction, or record it twice. The only errors the debit and credit system can reveal are those that leave the books out of balance.

Debits and credits can get very confusing! Fortunately, you can find inexpensive accounting software that will calculate them automatically.

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Being away from Guam for twelve years had one benefit: Jimmy was able to look at his former home in a new way. Things he'd grown up with and taken for granted looked different, and he found himself paying more attention to them.

He started taking a closer look at things like the water machines up and down Marine Drive.

The machines were owned by a widely respected company named Cloudburst. People brought old milk and soda containers, put in some coins, opened a glass door, and filled the containers with purified water.

One day, Jimmy went over to one to get a bottle filled. He put the money in, but nothing

happened. It wasn't the first time he'd run across a broken machine, either!

Jimmy looked at the machine thoughtfully. It was bigger than a Coke machine, but the machinery was probably pretty simple. It was apparently pretty breakable, too. Storms, misuse, vandalism...lots of things could go wrong.

It occurred to him that Cloudburst probably needed a good, mobile repairman to cover every machine on the island. There'd be simple handyman issues...things like broken glass, and jammed coin slots, that anyone could fix. But how many people knew how to repair water purification systems? For that matter, how many people knew how to maintain and clean them, so that the water would stay healthy and pleasant-tasting?

That was when I started to feel like I had an idea that could pay off: Repairing and maintaining the water purification system in vending machines. How many water machines were there, anyway? I drove around for a whole day. I saw lots of machines outside grocery and drug stores, of course. And Davy Flores, an old high-school buddy, told me there was a bunch more at the Anderson and Apra Bay bases. So it seemed at last like there was a service I could provide. Plus, I really liked the idea of working with a company like Cloudburst—a company I actually believed in, that was doing something to help people. What I didn't know was how I'd make my approach.

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Recordkeeping Requirements

The next step is to develop a recordkeeping system that you can use to track the income and expenses of your company. Keeping accurate records is one of the most crucial functions of a business owner. A recent study showed that the majority of business failures were because of inadequate recordkeeping. Many instances have been cited where the

business owners didn't even know they were out of business until their checks started to bounce.

You should set up your recordkeeping system using an accounting method that will provide you easy access to the financial detail that is required.

Why Keep Records?

Financial Management

- To provide financial background information for your business
- To produce financial statements
- To help you prepare taxes
- To assist you when borrowing money
- To assist you in decision-making
- To maintain managerial control
- To pay bills when due
- To collect bills regularly
- To stay on budget

Internal Controls

- To keep track of costs
- To prevent theft

Legal Issues

- To prove compliance with labor laws, workplace health laws, and other responsibilities
- To support your side in case of lawsuits

Decision-Making

- To provide information for budgeting and planning activities
- To monitor business progress

What kinds of records should I keep?

The business you're in determines the type of records you need to keep for federal tax purposes. Your recordkeeping system should include a summary of your business transactions, including your income, as well as your deductions. For most small businesses, the business checkbook is the main source of information in their recordkeeping system.

Here are some of the records you'll need to keep:

Items	How Long	Where to Keep
Tax Records	10 Years	File Cabinet
Canceled Checks	3 Years	File Cabinet
Bank Statements	7 Years	File Cabinet
Receipts (tax deductible)	10 Years	File Cabinet
Receipts (hi-cost buys)	Life of the Asset	Safety Deposit Box
Medical bills	3 Years	File Cabinet
Phone Bills	3-6 Years	File Cabinet
Deeds, Titles, Title Insurance	As long as you own the property	Safety Deposit Box

Tracking gross receipts

Gross receipts are the income you receive from your business. In most cases, this is the money you got from selling your product. Example of documents that show gross receipts include:

- Cash register tapes
- Bank deposit slips
- Receipt books
- Invoices
- Credit card charge slips
- Forms 1099-MISC

A quick word about terminology.

You will hear people talk about **accounting**, **recordkeeping** and **bookkeeping**. All three terms are used in this session. What's the difference? Well, in everyday usage there's very little.

All three terms refer to keeping track of business transactions with a system involving accounting, books, and records. The records are source documents that support amounts entered in the books, and allow for the accounting of your money.

Tracking expenses

This is the process of recording the costs it takes to run your business. Your supporting documents should show the amount paid and what the expense was for. Examples of documents for expenses include:

- Canceled checks
- Cash register tapes
- Account statements
- Credit card sales slips
- Invoices
- Petty cash slips for small cash purchases

A **petty cash fund** allows you to make small payments without having to write checks for very small amounts. Each time you make a payment from this fund, you should make out a petty cash slip and attach it to your receipt as proof of payment. An example would be buying a box of paperclips, a box of pencils, or some other small item. Try to avoid making too many purchases out of petty cash. Use checks whenever possible, because they're easier to keep track of.

How long do I need to keep these records?

It depends. Income-tax regulations require you to keep records during the three-year period that your tax return is subject to IRS audit. Sometimes, your records from seven years past may also be useful for tax purposes. You will need some past records during your business-planning process and when you analyze trends. The records are also very important for documenting the financial history of the business when it's being sold.

There isn't a complete, standard list of records and retention times that everyone follows, but here is one idea. Your accountant can help you modify this list to fit your business needs.

Type of Record	Retention Period
Bank Statements	7 years
Business Licenses	Until Expired
Cash Register Tapes	3 years
Check Registers	Keep Permanently
Canceled Checks	3 years
Financial Statements	Keep Permanently
General Ledger	Keep Permanently
General Journal	Keep Permanently
Inventory Records	7 years
Invoices (Accounts Payable, A/P)	3 years
Invoices (Accounts Receivable, A/R)	3 years
Property, Plant & Equipment Records	Keep Permanently
Purchase Orders	3 years
Receiving Reports	3 years
Tax Returns	Keep Permanently
Time Cards or Tickets	3 years
Travel Expense Records	7 years

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I started to think about what I'd need to get a contract with Cloudburst. A truck and a tool box, for starters. And of course, I'd need to present myself as someone who'd be an improvement over whatever system they had in place.

I'd need to do some more research, too. I took a couple more trips around the island, and I estimated that probably a quarter of the machines were out of order, for whatever reason.

Jimmy knew what made the machines tick, as far as the purification system was concerned. He knew how often they needed cleaning and maintenance, and he was pretty sure he could fix them if they broke. What was really going to be a problem was coming up with a budget for the work, especially since he'd had money management problems in the past.

He'd have to be very careful about finances and overhead, which meant researching his

costs thoroughly. Specialty tools and parts that were easy to get Stateside could be expensive and hard to find on Guam. Driving around the island could get expensive, too. And time-consuming, depending on the time of year.

The more he thought about approaching Cloudburst, the more Jimmy felt convinced that he'd need to be on top of the numbers. He'd need a financial plan more than a typical business plan. The first thing they'd ask, assuming they were willing to listen at all, would be "How much?" If Jimmy couldn't give them a number that made sense for them, he wouldn't get the contract. And if he didn't give them a number that made sense for *him*, he could end up earning less than it cost him to work.

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What Makes a Good Accounting System?

Your accounting system helps you keep track of financial information. You collect the data, record them, classify and summarize them, and report them in the form of financial statements. You need an organized method of doing this to avoid reporting incorrect or misleading information.

Keep it simple!

Simplicity is the key to a good accounting system; complicated systems often don't get used! Try to eliminate duplication of effort, summarize whenever possible, and set up procedures to eliminate guesswork and uncertainty.

Owner involvement

The best accounting systems are developed and operated under the watchful eye of the business owner. You don't have to do all the work yourself, but you must understand the system and be able to interpret the output. The more involved you are, the better your accounting system will function.

Internal controls

A good accounting system includes **internal controls**. These are standard practices that protect your business assets, and help you to comply with laws and regulations. Internal controls vary by business, but here are some basics:

- **The control environment.** This is a matter of setting a good example. If you do things carefully and honestly, your employees are more likely to do the same.
- **Authorization.** Make sure that the appropriate person authorizes purchases and sales. You must clearly state to vendors, banks, and other business partners what authority you have given to which employees.
- **Physical controls.** Blank checks and other documents should be pre-numbered, and locked away when not in use. Cash should be deposited daily.
- **Tickler systems.** A tickler system helps you keep track of current bills and orders. This can be a red folder for current orders, or a computer program that produces a daily report of due bills.
- **Monitoring and review.** You should regularly assess whether your internal controls are effective. Are they being used? If so, do they accomplish everything they're supposed to?

The Paperwork

Let's take a look at some of the typical paperwork used to document business transactions. You might not need all of these forms for your business, or you might find that additional paperwork is required. Standard business forms can be purchased in office supply stores, printed from the Internet, or ordered by mail from many companies.

Bookkeeping Tips

- Keep your system simple
- Make sure you understand the system
- Make bookkeeping a routine—don't wait until the end of the month or late at night to tackle it
- Have a reputable advisor set up your system and explain it to you
- Know the tax reporting requirements. Follow them.
- Keep your business and personal accounts separate

Common forms include:

Sales order form

You use these when you're dealing with wholesale buyers. If you don't want to use a sales order book, simply write an order on your business letterhead, and make a copy for the buyer. Note: Some buyers will give you their own purchase order. Make sure the buyer signs the purchase order, and that he or she agrees to all your terms and conditions as stated on your price list.



Purchase order

A purchase order is a written authorization to deliver a product at a specified price, which becomes a legally binding contract once the seller accepts it. You may receive purchase orders from buyers, as well as send them to sellers. A purchase order you receive from a shop or store should be acknowledged either with immediate shipment of the order, or by an order confirmation that indicates when later shipment may be expected.

When you use a purchase order for your own suppliers, it signifies you are a businessperson, not just a hobby business. This may help you in getting wholesale prices or credit. Purchase orders also help you to keep track of incoming supplies, invoices that must be paid, and the volume of business you are giving to each of your suppliers.

Price list

A retail price list is used for doing business with the public. An example would be a restaurant menu, a chalkboard describing your products and prices, or a summary of products and prices printed out on your stationery.

If you also sell wholesale goods, you must never place retail and wholesale prices on the same sheet. Instead, print individual price sheets for each. Your wholesale price list should state your conditions for new customers (e.g., credit references, or cash on delivery), your guarantee (if one

is offered), and your shipping charge policy. It should also show any price breaks you offer at different quantities.

Invoice

An invoice is a bill issued by a seller who has provided a product to a customer, which states the goods sold, the price, and the terms for payment. Standard invoice forms are available in three-, four- or five-part sets. However, many business owners now create their own computer-generated invoices. An invoice should include the following information:

- Seller's name and address
- Buyer's name and address
- Ship To address (if different from buyer's address)
- Date of invoice
- Date of shipment
- Method of shipment (e.g., U.S. mail, truck line, UPS)
- Invoice number
- Customer's purchase order number (if any)
- Terms of payment (e.g., net 30 days)
- Description of items shipped
- Quantity of items shipped
- Unit price
- Shipping charges
- Total amount

Packing list

The packing list is a checklist that buyers use when they're unpacking a shipment, to make sure that the goods match what's written on the invoice. The packing list must agree with the information shown on the invoice. This is why some standard

invoice forms include a packing list as one of the copies in the form.

Statement

A statement shows a customer's account balance at month's end. It shows the invoices you have sent and any payments that have been made against any unpaid (open) invoice. Statements provide a monthly recap. If a customer does not pay the invoice, send another invoice, not a statement. They are very helpful when you make several shipments to the same customer each month.

Time sheet

A time sheet states the number of hours that employees are eligible to be paid for. It's usually filled out by workers, and verified by their supervisor.

Payroll sheet

The payroll sheet is a summary of wages paid and withholding per pay period for each employee. Totals for all employees can be calculated, as well as tax liabilities. This can help you avoid penalties that are imposed for late or insufficient payroll tax withholdings.

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I talked to a couple of airmen and found out there were adult education courses at the base, that I could take for a fee. They had a class on simple budgeting, and one on financial planning. They weren't really business courses; it was more about basic life skills. But I didn't mind that. When it came to me and money, starting at the beginning seemed like the best way to go.

The classes were actually helpful. I learned that the first budget I had to create was one for my own spending. Dad had left us a little money, definitely enough for my classes and our living expenses while I came up with a proposal for Cloudburst. But if I wanted to have enough left over to get the business up and running, I'd have to set a strict budget, and stick to it for the first time in my life.

Jimmy sat down and made a list of necessities—gas, food, and his mom's medicine—and added up what they cost per week. Then, he listed the other, more frivolous things he spent money on...specialty coffees, for instance, and the occasional restaurant meal or magazine. These things were costing him an average of \$50 a month. Clearly, he'd have to give them up for a while.

It wasn't the most ambitious budget ever, but I felt good about doing it for the first time in my life. I went to the SBDC at the University too, and I read all I could find on financial planning, budgeting, sales forecasting, and how to sell your ideas to someone else. I also started making a list of the various natural problems on Guam, and how they affected the Cloudburst machines. I figured out what parts would cost, what equipment I would need, and what I would need for gas to run the business.

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Types of Accounting Systems

Your accounting system helps you keep track of your business's financial information. You collect the data, record them, classify and summarize them, and report them in the form of financial statements.

You need to set up an organized method of doing this, in order to avoid reporting incorrect or misleading information.

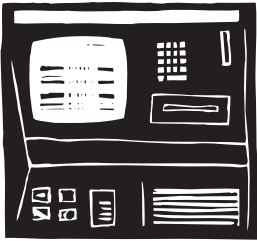
Computerized accounting systems

There are many accounting packages available to small businesses. The best of them allow non-accountants to accomplish such chores as inventory management, payables, receivables, and invoicing, while automatically taking care of entries, balances, and so on.

Accounting is a means of gathering financial information you need to run your business. Sometimes you need only the general picture, and sometimes you need detail. Your accounting system should offer both.

Most accounting software belongs to one of these groups:

- **Spreadsheets.** These programs are widely available and relatively inexpensive. Popular packages include Microsoft Excel, Abacus, Lotus 1-2-3, and Quattro Pro. Many small businesses choose to use spreadsheet programs because their accounting needs are minimal, and the programs are affordable.
- **General packages.** Several companies sell computerized accounting packages that can be adapted to most businesses. Leading sellers are Quicken, QuickBooks, and Peachtree. Some packages offer accounts payable, accounts receivable, and payroll modules, while others (like Quicken) are much simpler and include only a basic check register and cash receipts book. (The simpler packages may not have good audit trails.) It's usually best to start with a simple, inexpensive system, and add more sophisticated features as you need them.



The most important thing to remember is that even the fanciest accounting software can't do your thinking for you. To get the most out of it, you have to understand what you're putting into it, and why. Think of it as a glorified calculator: it can speed up tasks, but it can't run your business!

What do you need?

The type of accounting system you need depends on the type of business you run. If you sell products, you'll want to track inventory, shipping, and so forth. If yours is a service business, you may want to have a client management system of some type.

But most likely, you'll need a simple system that handles taxes, invoicing, purchasing, and all the basic accounting features. If you have employees, you'll also need a payroll module. Resist the temptation to buy features that won't save any time or solve any problems. Remember: Just because a

program can do something, doesn't mean it needs to be done at your business!

Choosing accounting software

Here are some things to think about when choosing accounting software:

- **Ease of use.** Can an average user figure the program out without first getting a PhD in advanced math? Realistically, how long will it take you to learn it? Remember to factor learning and training costs into the price of the system!
- **Range.** In addition to general ledger, accounts payable, and accounts receivable, what other modules or tools does it offer? Do you actually need them? It's a bad idea to clutter up your system with features you don't need!
- **Flexibility.** Can you easily customize the program? Does it mesh with other business applications, as well as e-mail and word processing programs?
- **Security.** Is it secure? Does it prevent unauthorized access to your data?
- **Add-ons.** Will you have to make multiple upgrades as you grow? If you're planning for a certain level of growth within a year or two, make sure your system will still meet your needs at that level.
- **Help.** Does the software program have an adequate help utility, help desk, or community user forum? Is the firm popular enough that it's likely to stay in business, so that it'll be able to offer support over the long haul?

It's a very good idea to seek advice from your mentor or adviser, who may be able to suggest a package that's just right for your business.

On the other hand, he or she may explain that you don't actually need a computerized system! Big software firms are eager to market accounting packages to microbusinesses, but in most cases,

they haven't tailored their products to the needs of a one-person business. Instead, they're marketing products designed for much larger businesses. Take advertisements with a grain of salt, and ask advisers and fellow microbusinesses about their experiences. You may find that you have no reason to buy an accounting system.

In the end, the question usually comes down to cost versus benefit. If the benefit you'll receive is greater than the cost of installing and working with the system, then it's probably a good idea. Remember to define costs very broadly; take into account dollars, time, and headaches! Accounting can be frustrating at the best of times; you don't want software that makes matters worse! Watch out for cramped and cluttered screens, and confusing instructions. Pick a program that's easy on your eyes, your brain, and your fingers.

Also, be sure to keep recording your information manually while getting used to your new system!

Manual accounting systems

For some micro-entrepreneurs, the cost of buying a computer outweighs the benefits of having a computerized accounting system.

Fortunately, many small businesses can get by with manual accounting systems. Here are a couple of the most common methods

- **Check registers.** This is the simplest form of manual accounting, and it's often sufficient for the needs of a small business. These differ from personal check register in that many columns are provided to record the source of cash receipts, or the reason a check was written. Monthly totals allow you to prepare a simple income statement, but it can be difficult to prepare a balance sheet from this information. You may need some help from your mentor!

- **Write-It-Once Systems.** These systems let you write one amount on a special carbonized form, and update several books at once. For example, before writing a check to a supplier, you would place forms representing the cash and payable accounts below the check. When you write the check, it automatically transfers the amount as a reduction to those accounts, eliminating errors that occur when amounts must be written in more than one place.

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If I were facing the same problem today, I'd have more options for seeking microcredit. But as it was, I wasn't sure where to turn. I thought about approaching the SBDC for a loan, but I was afraid it would take more time than I had.

I was getting down to the end of my money—and starting to think a job pulling snakes off phone lines might not be that bad after all—when I bumped into Ben Borja, who'd been a real good friend of my Dad's.

Ben asked me what I was up to, so I told him the whole story. I explained the situation with my Mom, and talked about my stateside experience with water purifiers. I showed him my sales forecast and budgets, too. I was proud of them, you know?

So to make a long story short, Ben was impressed and decided to lend me some seed money to get my business off the ground. Ben's family had always had money. In fact, he told me that right before I came home, he tried to get my Mom to take some money, but she refused. So he saw it as a second chance to help her. And like me, he was interested in anything that could improve the drinking water situation. So it was really a good fit. And what was even better was that he offered to mentor me. That could open a lot of doors, because he knew just about everybody on island. For me, it was like going from zero to 60 in a few seconds!

One thing I figured out from talking with Ben was that if I were going to get considered as a subcontractor, I had to offer things the current maintenance workers didn't. I decided one of my selling points was that I'd be available around the clock.

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Business Ownership and Tax Forms

In Session 5, we discussed the different ways you can set up your business legally. Most microbusinesses will be sole proprietorships or partnerships. But in any case, the choice you make will affect the kind of tax returns you will have to file, and the types of records you need to keep.

Tax issues and filing procedures are complex. Many of you will seek help from a professional tax preparer in the following areas:

- Federal tax issues, including income tax on the business, your personal income tax, federal employment taxes and insurance (FICA and FUI).
- State tax issues, including income on your business, your personal income tax, any other state business tax, state employment taxes and insurance (SUI and workers compensation).

Here are some of the most common forms used when filing a federal tax return for the four most popular forms of business ownership.

Income Taxes

As noted earlier, how your business is taxed depends upon its form of ownership:

- **Sole proprietorship.** Business income or loss is included in the personal income tax

return of the sole proprietor; the business does not pay income tax. The sole proprietor includes a Schedule C in his or her personal return, which is due April 15. The sole proprietor may also be required to pay quarterly estimated income taxes and self-employment taxes.

- **Partnership.** Business income or loss is included in the income tax returns of each of the partners; the business does not pay income tax. (This applies both to limited or general partnerships.) The partners list partnership income or loss on Schedule E with their personal returns. The partnership must file Form 1065 by April 15. Partners may need to pay quarterly estimated income taxes and self-employment taxes.
- **S corporation.** These work very much like a partnership for income tax purposes. Business income or loss “flows through” to the individual tax returns of the corporate owners. Form 1120S must be filed by March 15 and the owner may be required to make advanced payment.
- **Corporation.** The business’s income is taxed. The shareholders do not pay income tax on profits earned by the corporation, but when shareholders receive a dividend from the corporation, they pay personal income tax on that amount. The corporation files Form 1120 and pays its income tax by March 15. Corporations may be required to pay quarterly estimated income taxes.
- **Limited Liability Corporation.** LLCs are not taxed directly, so they enjoy the pass-through tax benefits of partnerships and S-corporations.

There are a large number of additional forms that may need to be attached to a business tax return. Check with an advisor who is knowledge-

able about business filing requirements, or plan to spend substantial time reading tax rules. IRS publication 334 is the main source of information for business deductions, with references to other publications. Each state also has its own set of instructions to explain the particular state's filing requirements.

Other states have a similar number of forms to the IRS, and the process of filing a state return can be just as time-consuming and difficult.

It's your responsibility to make sure all required forms are filed. This is true even if you hire someone to fill out the forms for you. Find someone who is knowledgeable and that you can understand. Keep asking questions and reading until you understand your responsibilities. You cannot claim ignorance ("I didn't know I had to file that form") as a defense, so get help if you need it!

Getting Professional Help

Few small businesses can get by without some professional accounting assistance. The good news is that there are numerous accounting services to choose from:

- **Bookkeeping.** You can hire a bookkeeping service to do any or all of the tasks required in your system. Often, outside services are used for Accounts Receivable, Accounts Payable and Payroll.
- **System design.** You may need help designing your accounting system and internal controls. A consultant or mentor can help you set up a system correctly, so that you'll start out on the right foot.
- **Income taxes.** You'll almost certainly need help planning for and preparing your income tax returns! Find an accounting professional

who works with your type of business.

- **Write-up.** You may be able to maintain the books yourself, but need help putting together the financial statements and other reports. Some firms will help you design your accounting system based on software they use. You give the firm your accounting information in the form of input sheets, and the firm's personnel enter it into their computer. Then, they produce the reports and forms you need to run your business and file your taxes.
- **Auditing.** As your business grows and prospers, you may need an independent audit. Sometimes an audit is required by loan agreements or when a business is to be sold.
- **Temporary services.** Perhaps all you need is some help getting through the year-end closing of your books or preparing your annual budget. Maybe you have a busy season when extra help with Accounts Receivable or Inventory would be great. Consider using one of the temporary service agencies in your area.

The Resource Guide at the end of this book can help you find free and low-cost services targeting micro-enterprises.

How to Choose a Bookkeeper/Accountant

- **Ask for referrals.** Find out who other business owners use, and whether they're satisfied.
- **Check references.** Be sure previous clients were happy with the person's performance. Check credentials, too!
- **Be clear** about the information you need, and the work you want done.
- **Get involved** and check to see that everything is functioning correctly.

- **Review** all of your financial statements carefully.
- **Trust and honesty.** You'll need to be very open with your accountant, so be sure to find someone that you like and trust.
- **Remember that most professionals charge by the hour.** It will save you money if you give them complete, organized information.

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With Ben's \$7,500 loan, Jimmy went out and bought a used utility truck, a set of tools, some nice clothes, and a new pair of shoes. At last, he was ready to arrange a meeting with Cloudburst.

They were impressed with the detail and scope of his presentation. The positive references from the water purification firm in Iowa City didn't hurt, either; Jimmy had made better use of his time on the Mainland than he'd thought!

Cloudburst had been using a makeshift maintenance crew, most of whom were part-time and not always available. Also, they had little training, and knew nothing of mechanics beyond the standard problems. They could fix a sliding plastic door, or a broken coin sorter. But they had limited skills when it came to the purification system. And they weren't on call 24/7.

After a couple more meetings, Cloudburst agreed to hire Jimmy as a subcontractor, on a six-month trial basis. If his work was satisfactory, they'd consider giving him a contract to do all their maintenance work, all over Micronesia. Jimmy intends to see to it that they do just that!

So did my budgets and sales forecasts get me where I am today, or Ben's money? To me, it's obvious that working through the financial side of things is what did it. It gave me confidence. I knew the numbers inside and out. I went from feeling like

my idea might work, to completely believing in it. And that's why I was able to spark enthusiasm in other people. I know now that if you can plan and budget intelligently, people are impressed!

I'll go even further and say that if I hadn't done that preliminary work, I might not have been able to do such a good job even if they did hire me! I know it might not sound like a big deal to a lot of people, but being able to create a personal budget, and stick to it...I feel like that's what gave me the self-confidence and discipline to do everything I've done since then. Understanding the essentials of planning, budgeting, and bookkeeping has made a big difference in how I work, and who I am.

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What You've Learned

In this session, you learned:

1. Your first task in financial management is to develop a mindset for business and financial success.
2. You must keep your personal finances and records completely separate from those of your business.
3. Recordkeeping may not be fun, but it's something every successful owner does to stay in business.
4. One of the best ways to gather business information is through a good accounting system.
5. Accounting systems don't run themselves! You need to understand the system, and get involved in it.
6. Professional help is available from bookkeepers, accountants, and other professionals.