TEN SIMPLE MONEY RULES

FOR YOUR SMALL BUSINESS

TEN SIMPLE MONEY RULES
FOR YOUR SMALL BUSINESS

Almost half of all new small businesses started in the U.S. will close within the first five years, according to the U.S. Small Business Administration. The #1 cause of this bleak statistic is poor financial management.

Understanding of some basic rules of business financial management, namely – bookkeeping, can eliminate most problems. Ten of the most common bookkeeping mistakes made by small businesses are listed in this report… and how your business can avoid making them!

1. Combining Personal and Business Finances

It is critical that personal and business finances be kept separate at all times, regardless of a company's size. One of the first things a new business owner should do is to open a business checking account. All *business* income is deposited into this account.

The next step is to work with an accountant to figure out a management strategy, when your earnings start to grow. Having a strategy in place ahead of time will dictate how much cash to remove from the business to meet personal expenses and achieve savings goals. This management strategy will be driven by a few factors, including:

1. The amount of profits to be reinvested into the company
2. The timing of large business expense payments or payoffs
3. Cyclical or seasonal business cash needs
4. A long-term *personal* financial strategy.

2. Using the Wrong Accounting Method

There are two main business accounting methods: cash and accrual. Cash accounting is the simpler method because it is based on the actual flow of cash in and out of a business. The cash method is used primarily by sole proprietors and businesses with no inventory. The second accounting method is the accrual method records income and expenses as they occur, whether cash has actually changed hands or not, i.e. invoice today with payment in 60 days.

As businesses grow (make more money), accounting becomes more complex. The decision to switch from cash to the accrual method is a decision, which requires a meeting with your tax preparer and/or CPA. There are a variety of reasons for the switch. A classic example is when a business looks profitable during months with few expenses and unprofitable during months with large expenses. If the business changes from cash accounting to accrual, the expenses are spread over a longer time as well as the income. The result is a profitable company over all the months without a spike of expense or dip in income.

3. Account Reconciliation – Monthly/Quarterly

The first item on your ***Monthly Bookkeeping To-Do List*** is to reconcile your business checking, savings and reserve line (if you have one). The "bible" for this process is your bank statement(s), *not your computer accounting software*. The bank rules! You compare the bank statement transactions to your computer entries. If there is a mismatch, the mistake will be in your entries usually.*

Monthly reconciliation takes time at first, and goes a little faster next time. But, it is an important process, so rushing is not an option. Your friendly banker will show you how to reconcile, if you don't know how. It is nothing to be embarrassed or worried about. If you have invested in accounting software, i.e. QuickBooks, you are entitled to all sorts of benefits, including tutorials. Lastly, if you need one-on-one assistance, ask fellow entrepreneurs how they learned. Keep in mind, I am "The Fearless Bookkeeper." My whole mission is for you to *fear less*. Just email or give me a call. I can help you learn how to reconcile your accounts.

*If you think the bank made a mistake, contact your bank right away to get them resolved. Be sure to obtain the person's name with whom you are speaking, so you can call them again in the future.

Reconciling on at least a quarterly basis helps ensure that accounting errors are caught and corrected quickly before they result in major financial problems.

4. Petty Cash

While the word "petty" means small, petty cash in the business sense is no small matter. Every business should have strict office procedures in place, when a petty cash account is deemed necessary. The purpose of petty cash is to cover unforeseen (unplanned) expenditures, i.e. ink cartridge, delivery fee.

A relatively simple accounting system for petty cash includes the following:

a. Petty cash manager (usually office manager)
b. Petty cash voucher book, also known as a "log"
c. Petty cash receipts envelope
d. Petty cash (small bills and $5 in change)
e. Petty cash "bank" or locked box in which all of the above is kept.

The process begins on a Monday morning with a complete accounting of the "bank." Funds are replenished for the week, with a starting balance of (whatever the business owner decides is necessary, usually $50 or $100.)

Vouchers are filled out by the person requesting money. A new voucher should be filled out for *each* expenditure. The transaction receipt along with any change is then returned to the Petty Cash manager for further processing. **Reminder**: The Petty Cash Manager is the *only* person to have access to this locked box.

It is highly recommended that Petty Cash be reconciled weekly, i.e. after lunch on Friday. This allows petty cash accounting to be completed and any missing receipts can be located prior to the weekend. Petty Cash will then be ready to go on Monday morning.

Proper expense planning and office supply ordering can eliminate many last minute (and more expensive) purchases. It is, however, always nice to know there is some cash in the office. Emergencies are never planned and so, that's why there is Petty Cash.

5. Free Bookkeeping

Obviously, we think we can do it all, when it comes to our businesses. We are entrepreneurs! Of course, bookkeeping is among our duties – along with marketing, producing our product/providing our services, marketing, working and managing our home lives. And we do the bookkeeping. Really? The thought flows through your mind "…maybe I should hire a bookkeeper?"… then the next line is "I can do this! I'm not hiring anyone to do *"this."*

The fact is you can do the bookkeeping… if:

1. You have an understanding of bookkeeping.
2. You have been trained in an accounting software.
3. You know how to read financial reports.
4. You can spot the fact your liabilities are not current
5. You have no problem spending at least four hours a month doing bookkeeping. *

*Four hours is the approximate time it takes for a *growing* business to keep its monthly books. It wouldn't be long before your DIY approach to business would be operating at a loss.

"A loss? What loss? I'm doing the bookkeeping. I am *free*." Let us visit this theory.

For the sake of this example, pretend it takes you approximately four hours a month to do your business bookkeeping. Keeping it simple, four hours x 12 months is 48 hours of your time doing your books "for free." Now, consider the following:

What is your hourly rate for what you do… as in what service you are selling or product you manufacture? Do you charge $60, $80 or $100 per hour? So, we take the 48 hours multiplied by your hourly rate, i.e. $80. $80 x 480 hours is $3840. In what could have been "billing hours, " you lost $3840 in earnings doing your own books!

Remember the ***Golden Rule of Small Business***: *Try to work on your business instead of working in your business*. Bookkeeping is one instance where the DIY attitude can trip you up.

A professional bookkeeper would charge less than $80 per hour. You would still *earn* some money, if you hired someone and your books would be current.

Your business might not need monthly bookkeeping, but the books should be reconciled at least quarterly. You might need a tutorial in office processes or learn an accounting software to expedite the whole process. Depending on your business demands, and how you want to spend *your* time and talents, run the formula stated on the previous page every so often to see if it is time for a professional. A couple of hours spent quarterly with a professional bookkeeper can keep you on track through the year, saving angst and money at tax time.

All bookkeepers are not the same. Depending on your industry and size of your business, you will have a field of options from which to choose. Hiring an independent contractor for a quarterly review will remove any hesitation you may have toward your own work. If this works, but you find yourself falling behind due to other obligations later in the year, the same independent bookkeeper can then easily visit the office and take over. If space is a problem, many offer to pick up and deliver and some work online. There is a bookkeeper out there for you and a way to solve your bookkeeping problems without hiring an employee for the job.

Lastly, think of a bookkeeper as *your* December bonus! Your books will be in order on December 31! The frustration, worry and sleepless nights of last year's tax season are now a mere memory. With a professional bookkeeper, your bookkeeping will be in order for yearend review by mid-December. There is no rush, no surprises. The only element to be done in January is December's reconciliation.

The yearend financials - Profit & Loss, Balance Sheet, General Ledger and Journal- will be printed, reviewed by you for any corrections and revised. Final financial reports, along with your 1099's – if any, can be given to your CPA by mid-February! How you ever been so prepared so early?

As the first to arrive at the CPA/tax preparer's office for the new tax season, be bold! Go ahead! Ask that tax preparer for your "***Early Bird Discount***!"

And it's all because you knew your time was better spent working on your business and hired a professional bookkeeper. That's your secret. www.fearlessbookkeeping.com

6. Time to Hire?

In the eyes of the Internal Revenue Service, there are several different categories of workers: full-time, part-time, and temporary employees, as well as independent contractors, such as freelancers and consultants and lastly, interns.

Before placing an ad on FaceBook or Craigslist, find your yellow pad. Take an *un-interrupted* hour to decide what you need, who you might need and if you can afford this "help." It can prove very costly to have your "help" misclassified.

Make four columns:

1. Tasks Required (the reason for this exercise)
2. Time Required to accomplish
3. Special knowledge or talent for person in this job
4. Amount budgeted

There are various types of labor available to small business. It is important to know a few differences among them. For instance, there are no benefits for temporary employees or independent contractors.

Independent contractors take care of themselves. The employer is not responsible to them for providing minimum wage, overtime, payroll tax, workers' compensation, or unemployment compensation laws. This class of worker is also referred to as a "1099." This number refers to the tax document issued to independent contracts at yearend, stating the income paid to them, instead of a W-2, which states the year's wages to actual employees.

Employee benefits are determined by employee eligibility. An employer usually offers full benefits to full-time employees; sometimes part-time employees are eligible for a share of benefits. This "share of benefits" is called "pro rata."

It is recommended that you visit your state's Secretary of State website, as well as that of the U.S. Small Business Administration, to see what other laws might pertain to employer responsibilities in general and to your industry, in particular. Note that while federal rules are in place throughout the county, state rules vary state-to-state.

7. Profits and Cash Flow – is there a difference?

It seems unusual, but a business can have positive cash flow in the short term, but still be unprofitable. It is also true that a business can have negative short-term cash flow, but still be profitable in the long term.

The first scenario is common among small businesses because they often have to pay suppliers before they get paid by their customers. The second scenario is common among point-of-sale and cash-based businesses, such as retailers, that pay their vendors on terms. This point was covered above in Rule #2. The type of accounting method you use can account for a big difference in how the balance sheet appears, even though it is using the same numbers.

This example speaks directly to Rule #5 – that is, the need for a professional bookkeeper. Monthly financial statements will allow you to gain insight into your spending habits opposite the time it takes for you to be paid. The four financials you should receive at least quarterly consist of The Balance Sheet, The Profit & Loss Statement (also known as an Income Statement), the General Ledger and Journal.

A professional bookkeeper will not only "do your books," this person will/should take the time to ensure that you understand what the report is telling you. This is not a judgmental practice in the least. Rather, it is incumbent upon any professional to explain easily and fully the work that has been entrusted to them. It is that important. Be sure to allot enough time for this monthly meeting. Ask for this meeting, if you are not asked about it. They are *your* books!

8. Not Saving Receipts

Be ready? For what? Well, there is always the possibility that you might be audited by the IRS one day. If that day comes, your stress factor will diminish considerably, if you already have things in place. One of the biggest pieces of an IRS audit is receipts. If you gather as you spend, the monthly receipts are given to the bookkeeper for further processing and storage. No need to do anything further. But, you will be ready if you are asked.

The Dollar Store is a wonderful place to buy office supplies! Aside from the price point, the folders, envelopes, holders of all kinds, come in cardboard, plastic, elastic and paper. They are red, white, blue, screaming yellow and traffic green. Buy several of these and put them in obvious places, i.e. your car, your dresser, your kitchen… any place where you might leave a receipt as you clean your car, your pockets or your purse. In addition to being clean, you will make life much easier for your bookkeeper (!) and you will be ready.

And it's not just the big expenses. The Internal Revenue Service (IRS) requires that expenses for business travel, meals, and entertainment that are greater than *or equal to* $75 be substantiated with a receipt, if they are to be considered a "deductible." That's fine. But keep *ALL* receipts in any case.

While such receipts may not technically be required by the IRS, they are extremely helpful as *backup documentation*. Back-up documentation lends credibility to a trip expense or the reason for the trip in the first place, if there any IRS questions.

Receipts also have a way of prompting more questions, when you meet with your tax preparer. The littlest receipt might reap great rewards to you as it leads to a discussion of a very legitimate deduction you never thought of. Keep your receipts.

9. Paperless is the best way! Not.

While "green" is a way of life for many environment-oriented companies, the world of bookkeeping and accounting are old school. There is no replacement for hard copy documents or paper receipts. This does not mean an expense, as stated on a credit card statement. This means *the receipt for the expense* on the credit card statement!

Going back to Rule #8, where you need to be prepared "for that day.."… It is easier, and much more impressive, to pluck out a receipt from the envelope for that month for a transaction in question, rather than search for it online with an IRS auditor sitting in front of you! Now, that is stress.

Computers have the second sense of when they are needed most… and then, the electricity goes out or it goes black with the agent right there, waiting for an explanation! Yikes.

Instead of this scenario, you will be able to reach into your brightly colored envelope to find the requested receipt among the well labeled monthly-bundled papers, assembled months prior. Yes!

Again, Dollar Store storage folders – keep receipts. Each year pick a different color; at year's end, place all folders in a larger tub (need not be the same color) labeled for that year and store.

Begin again. If the day comes and you receive that appointment date and time for an IRS audit, you simply pull out your tub. That is it. You have everything you need.*

*I put an asterisk because you will also need your tax return copies. This should, of course, be stored separately in a locked file someplace else. Your tax preparer should attend this meeting as well.

10. Old Fashioned Internal Controls

It is a proven fact that more small businesses fail because of fraud and embezzlement more than any other reason. And, this is usually done by relatives! Remember, they might work for "free."

The accounting department – also known as "the back office" - is where it all happens. This is the place where money arrives and departs. Petty cash is accounted for here; invoices are written, payments received. Bills are input, scheduled and paid. Checks are printed, signed, copied and mailed. Payments are received/posted and deposited. Payroll is figured out and either sent to the payroll company or completed in-house. Who has access to these processes in the computer, the files and the desks is a primary security consideration. The person who prints the checks, should not sign them.

No one person should be in total command without oversight of some kind. Even the bookkeeper, though entrusted with final reconciliations and financial reporting, should be overseen at least bi-annually by the company owner or CPA.

Author's Note:

I hope you find these ***"Ten Simple Money Rules"*** of assistance, as you set up your business or decide what your next bookkeeping step may be. Fear is only as strong as we give it credit to be. Knowledge removes fear and replaces it with understanding. To understand a challenge results in confidence. This is how learning works. Fear less. Become a confident business owner!

If you have any bookkeeping questions, I would be happy to help - maryjane@fearlessbookkeeping.com!