Overview:

Overview of accounting topics for small business, including accounting principles, budgets and payroll.

*1.0 CAS

Basic Accounting For Small Businesses

Renee Pargo
Basic Accounting Principles-overview

Introduction

• Creativity and determination will get a business off the ground

• Accounting records will tell you if you are making money or not

• Accounting analysis will help you to make informed decisions about the future of your business

Why Keep Accounting Records?

• To report business activity to the government

• To obtain cooperation with creditors

• To monitor your business’ health and success

• To communicate your business status to advisors
What Are the Major Components of an Accounting System?

• Paper Records
  – The proof you have of the transactions in your system
  – Primarily kept for government users

What Are the Major Components of an Accounting System?

• Chart of Accounts
  – The categories into which you will separate transactions
  – Plan your chart of accounts based on the reports you want to end up with
  – Be sure to include accounts for anything that has tax implications, like transactions that might be deductible expenses

What Are the Major Components of an Accounting System?

• General Ledger
  – Where transactions are recorded and categorized
  – May or may not be visible depending on your system
  – Uses the double entry accounting system (i.e. debits and credits)
What Are the Major Components of an Accounting System?

- Reports
  - Useful outcome of accounting systems
  - Most accounting systems have a wide variety of reports

Major Financial Reports

What Are the Major Financial Statements?

- Balance Sheet
  - A listing of critical account balances at a particular point in time, usually the end of a month
  - Similar in concept to a bank balance
  - Contains a lot of useful information about the health of a business at a particular point in time
What Are the Major Financial Statements?

• Balance Sheet

<table>
<thead>
<tr>
<th>Account</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts receivable</td>
<td>$1,780</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>1,590</td>
</tr>
<tr>
<td>Prepaid expenses</td>
<td>951</td>
</tr>
<tr>
<td>Cash</td>
<td>4,520</td>
</tr>
<tr>
<td>Accounts payable (non-current)</td>
<td>10,000</td>
</tr>
<tr>
<td>Long-term debt</td>
<td>1,000</td>
</tr>
<tr>
<td>Total liabilities</td>
<td>15,520</td>
</tr>
<tr>
<td>Total assets</td>
<td>690,000</td>
</tr>
<tr>
<td>Earnings (loss)</td>
<td>(11,935)</td>
</tr>
<tr>
<td>Owner’s equity</td>
<td>1,000</td>
</tr>
<tr>
<td>Total liabilities &amp; owner’s equity</td>
<td>$67,490</td>
</tr>
</tbody>
</table>

What Are the Major Financial Statements?

• Income Statement or Profit & Loss Statement
  – A summary of transactions that occurred in a particular period of time, usually a month, quarter or year
  – Similar in concept to a bank statement
  – Contains a lot of useful information about the health of a business over a particular period of time

What Are the Major Financial Statements?

• Income Statement or Profit and Loss Statement

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total revenue</td>
<td>$114,540</td>
</tr>
<tr>
<td>Less expenses</td>
<td>(61,460)</td>
</tr>
<tr>
<td>Sales revenue</td>
<td>12,000</td>
</tr>
<tr>
<td>Gasoline expense</td>
<td>14,430</td>
</tr>
<tr>
<td>Insurance expense</td>
<td>5,500</td>
</tr>
<tr>
<td>Operating expenses</td>
<td>6,750</td>
</tr>
<tr>
<td>Taxes expense</td>
<td>1,430</td>
</tr>
<tr>
<td>Total expenses</td>
<td>77,140</td>
</tr>
<tr>
<td>Net income</td>
<td>37,400</td>
</tr>
</tbody>
</table>
What Are the Major Financial Statements?

- Statement of Owner’s Equity
  - A summary of owner’s equity transactions that occurred in a particular period of time, usually a month, quarter or year
  - Shows the changes in status of an owner’s investment/return
  - Has more to do with an owner’s activities than the business’ health

What Are the Major Financial Statements?

- Statement of Owner’s Equity

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beginning balance, Jan 1</td>
<td>$ -</td>
</tr>
<tr>
<td>Increases</td>
<td>$46,000</td>
</tr>
<tr>
<td>Decreases Have Retained</td>
<td>$80</td>
</tr>
<tr>
<td>Net income</td>
<td>$45,200</td>
</tr>
<tr>
<td>Ending balance, Jan 31</td>
<td>$45,120</td>
</tr>
</tbody>
</table>

What Are the Major Financial Statements?

- Cashflow Statement
  - A summary of all cash transactions that occurred in a particular period of time, usually a month, quarter or year
  - Most accounting systems will produce a cashflow statement based on recorded transactions, but only after the transactions are entered
  - If your business runs tight on cash, this statement should be created in advance for planning purposes
What Are the Major Financial Statements?

• Cashflow Statement

<table>
<thead>
<tr>
<th>What Can I Learn from a Balance Sheet?</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Balances of Critical Accounts</td>
</tr>
<tr>
<td>– Cash</td>
</tr>
<tr>
<td>– Accounts Receivable</td>
</tr>
<tr>
<td>– Accounts Payable</td>
</tr>
<tr>
<td>– Owner’s Equity</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>What Can I Learn from an Income Statement?</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Critical Figures</td>
</tr>
<tr>
<td>– Revenue</td>
</tr>
<tr>
<td>– Expenses</td>
</tr>
<tr>
<td>– Net Income</td>
</tr>
</tbody>
</table>
What Are Some Other Important Things to Look At?

• Critical Business Ratios
  – Current Ratio
    • Measure of whether or not a firm has enough resources to pay its debts over the next 12 months
    Should be greater than 2, but varies greatly by business type
  – Profit Margin on Sales
    • Measure of profitability in a period
    • Should ideally be an upward trend

What Are Some Other Important Things to Look At?

• Critical Business Ratios
  – Times Interest Earned
    • Measure of earnings versus required interest charges
    • Higher ratios mean a smaller percentage of your earnings are going to creditors
  – Accounts Receivable Turnover
    • Measure of how many times receivables turn over in a year, and therefore average collection period
    • Consider the credit terms you offer – the longer the collection period, the more funds are tied up in receivables, restricting cashflow

What Are Some Other Important Things to Look At?

• Critical Business Ratios
  – Return on Assets or Return on Investment (ROI)
    • Measure of profitability on investments, or how well the investments were used
    • Varies greatly based on risk and return expectations of the owner
What Are Some Other Important Things to Look At?

• Trends
  – Changes in Account Balances or Critical Figures Across Successive Periods
  – Used to Measure a Huge Variety of Things
    • Trending Sales Will Indicate Business Growth
    • Trending Interest Will Indicate Reduction of Interest Expenses
    • Trending Accounts Receivable Turnover Will Indicate Results of Increased Collection Efforts
What Are Some Other Important Things to Look At?

- Trends

Accounts Receivable Turnover Trend

Budgets

Budgeting is critical in business, no matter what size your business is.

Small Business Budgeting

- What is a Budget?
  - Forecast of all cash sources and cash expenditures.
  - Most commonly covers a 12-month period
  - At the end of the year, anticipated income and expenses developed in the budget are compared to the actual performance of the business
  - Contains 3 main elements: Sales, Expenses & Profit
Small Business Budgeting

• Why Do You Need A Budget?
  – Helps you decide whether you have enough money to achieve your financial goals
  – Allows you to anticipate problems before they occur and alter your plans to prevent potential problems
  – Help convince a loan officer that you know your business and have anticipated its needs

Small Business Budgeting

• The Budgeting Process
  – Before you can create a budget
    ✓ Do a reality check
    ✓ Based on figures that can be supported by reasonable expectations.
  – Specify a timeframe
    ✓ Often based on fiscal year, but you may also want to budget on a monthly, quarterly or semi-annual basis
  – Estimate Income and Expenses

Small Business Budgeting

• You must answer three questions:
  ✓ How much net profit do you want the business to generate during the calendar year?
  ✓ How much will it cost to produce that profit?
  ✓ How much sales revenue is necessary to support both profit and costs?
Small Business Budgeting

AAA Pool Supply Company
Budget

<table>
<thead>
<tr>
<th>Item</th>
<th>Budget</th>
<th>Actual</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>$500,000</td>
<td>$500,000</td>
</tr>
<tr>
<td>Cost of goods</td>
<td>$200,000</td>
<td>$200,000</td>
</tr>
<tr>
<td>Gross profit margin</td>
<td>50%</td>
<td>50%</td>
</tr>
</tbody>
</table>

Operating expenses:
- Advertising: $3,405 (6.3%)
- Rent: $6,000 (10.0%)
- Insurance: $2,000 (3.3%)
- Legal and accounting expenses: $6,122 (10.5%)
- Office expenses: $2,000 (6.7%)
- Travel: $2,000 (3.3%)
- Sales salaries: $66,400 (11.2%)
- Utilities: $4,000 (6.9%)
- Miscellaneous: $3,237 (5.6%)
- Total operating expenses: $82,545 (14.6%)
Net income: $47,455 (11.4%)

Payroll for Small Business

- All wages are subject to federal employment taxes unless the payments are specifically exempted under the Internal Revenue Code.
- Wages subject to federal employment taxes generally include all pay that you give to an employee for services performed.
- The pay may be in cash or in other forms. It includes salaries, nonqualified deferred compensation, vacation allowances, bonuses, commissions, and fringe benefits.
Payroll for Small Business
• Each state has adopted its own unique set of employment laws. As a result, each state has its own policies, procedures, forms, and requirements.

• Almost all states have adopted a state income tax. Each employee’s wages are subject to state income tax withholding.

• These amounts are deposited with the appropriate state tax agency and quarterly and/or annual reports are prepared to summarize the payroll activity of the employer throughout the reporting period.

Payroll for Small Business
• There are generally three types of federal employment taxes:
  – Employee Income Tax Withholding
    ☑ Amount withheld from employee’s wages to offset projected income tax
  – Federal Insurance Contributions Act (FICA)
    ☑ Consists of 2 components (Social Security & Medicare)
    ☑ Provides for old age, survivors and disability insurance (OASDI) and hospital insurance (HI)
    ☑ The OASDI component is financed through the social security portion of FICA and the HI component (for persons 65 or older) is financed through the medical portion
  – Federal Unemployment Tax Act (FUTA)

Thank you so much for your time and attention.

Questions?

[Contact Information]