3.0 FINANCIAL CONSIDERATIONS

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3.1 Introduction and Summary

Maintaining accurate business financial records is essential to managing a business. Among other things, an adequate record-keeping system provides owners of the business with the ability to 1) assess trends in the business, 2) monitor and control costs, 3) anticipate expected cash receipts and cash disbursements, 4) assess profit performance of each of various segments of the business, 5) provide customers with accurate invoices and, 6) give historical information that will aid in forecasting future performance.

3.2 Accounting Systems

A double entry system, where credits equal debits, is employed to help detect errors in the recording process. Accounts may be maintained either on a cash or accrual basis. Where a business sells on credit or maintains inventory, an accrual system is preferred. Today's accounting software (discussed below) allows statements to be readily converted from accrual to cash, which is particularly helpful for businesses that choose to report taxes on a cash basis.

3.2.1 Elements of an Accounting System

Chart of accounts – represents a means of assigning, or coding, numerical transaction entries, which thereby tie these entries to particular elements of each of the financial statements. Particular care needs to be expended to establish a chart of accounts that tracks expenses and assets that are relevant to the particular business. Businesses with several product lines may wish to establish various sales account codes for each product line, associated cost of sales accounts and expense reports that allow detailed examination of expense trends and financial statements for each line. Business owners are well advised to consult with a CPA in the early stages of establishing a chart of accounts.

Transactions – Through the use of accounting software, each individual transaction is recorded, ideally when it occurs or shortly thereafter. Most accounting software will allow sales invoices to be customized for the business and will permit the creation of purchase orders and tracking of cash receipts. While payrolls can be prepared on most accounting software packages, businesses may wish to utilize inexpensive third party payroll companies to avoid the constant need to keep abreast of payroll tax changes.

Ledgers, Trial Balances and Journals– Accounting software will produce a variety of reports that detail transactions in various summaries to allow entries to be analyzed. See Glossary for a definition of terms.

3.2.2 Selecting an Accounting System

Given today's inexpensive accounting software systems, most small businesses should seriously consider maintaining their accounting records on their own system. However, if the owner has limited interest in learning an accounting system, bookkeeping services or accounting firms can be hired to maintain accurate records. If such services are employed, it is essential that they produce financial statements frequently (at least quarterly, preferably monthly) and in a timely way.

Accounting software permits customizing reports on various segments of the business so that the effects of actions taken can be evaluated from a financial perspective.

Software available:

- Quicken for Home and Business ($79.99) (www.quicken.com) - Provides basic accounting functions for a business that does not maintain inventory.
- Quickbooks ($149.99) (www.quickbooks.com) - the most popular small business accounting package. Provides full functionality for business including inventory. Tour of package is available on above website. SCORE offers introductory workshop on how to use this package.
- Quickbooks Pro ($249.99) (www.quickbbooks.com) - Allows for networking of Quickbooks if you have various users.
- Peachtree (www.peachtree.com) - Provides a variety of packages similar to Quickbooks, except most of programs retain traditional double entry format, except their One Write product that is similar to Quickbooks format. Many products are can be networked.

3.3 Financial Statements *are representations of the financial state of a business. They should be produced monthly, showing actual results compared in detail versus the budgeted or forecasted figure that was previously entered. Particular attention should be paid to the* Cash Flow Statement*, (see below) to identify undesirable trends such as excessive increases in Receivables or Inventory.*

3.3.1 The Cash Flow Statement is exactly what the name implies: an accounting representation of the cash amounts coming in over a period of time compared to the cash amounts going out over the same period. The cash flow statement shows the actual movement of cash within a business; it is an analysis of all the transactions that affect the cash account during an accounting period and presents the initial and ending cash balance for the period. In the analysis, *sources of cash* are shown along with *uses of cash.* When more money comes in than goes out, we speak of *positive cash flow*. Conversely, when more money goes out than comes in, we speak of *negative cash flow.* Companies with assets well in excess of liabilities can nevertheless go bankrupt in the case where they cannot generate sufficient cash to meet current obligations.

3.3.2 The Income Statement, also called a profit and loss statement (or simply, P&L,) is a detailed statement of income (also termed sales or revenues,) expenses (also termed costs) and taxes, revealing the operating position of the business over a period of time. Thus the income statement displays whether the business has made a profit or sustained a loss during the accounting period.

3.3.3 The Balance Sheet of an individual or business presents the assets, liabilities and net worth on a given date, usually the close of a month. The Balance Sheet represents the financial state of a business, indicating in two columns the value of materials or equipment owned (*assets*) listed in the left hand column, with monies owed to others (*liabilities*) and the amount owed to the owners (*net worth or owner's equity*) in the right hand column. Assets on the left are equal to the sum of liabilities and equity on the right, representing a balance, hence the name.

3.3.4 Financial analysis is the process of identifying and investigating causes of significant variations in particular accounts against the budgeted or forecasted figures, against prior period performance and/or against a benchmark such as industry average of profitability, cost of sales, etc. Focusing monthly on the actual performance against the above standards provides an early warning of deviations from expected performance and allows prompt operational adjustments to be made. SCORE provides counselors free of charge to assist in analyzing financial performance and to suggest remedial courses of actions.

3.3.5 Standards of Performance facilitate the evaluation of performance against businesses in similar industries. Robert Morris Associates publishes these standards and other statistical data for a range of businesses. These standards may be helpful in evaluating performance against peers. SCORE has copies of RMA surveys available in the *Business Resource Center* (see Section 12.)

J M Adams
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