It is imperative that you establish a record keeping system before the doors of your business open. Accurate books and records are essential for business planning and useful to management in making informed decisions. DON'T WAIT until it's too late and GET HELP if you need it.

BASIC RECORD KEEPING

The record keeping needs of your business must be analyzed to determine the best bookkeeping system. All systems should provide the following information:

- Detailed operating statements
- Comparison of current results to budgets and prior periods
- Financial statements
- Information for tax returns and reports to regulatory agencies
- Sufficient control to protect assets and detect errors

Each business has special needs that must be considered when establishing a bookkeeping system. Factors you should take into account include: legal structure of your business, your industry, the number of employees you have, the number of product lines or services and the number of locations your business operates.

The first step in setting up a bookkeeping system is the selection of the tax year or year end. The term "tax year" refers to the annual accounting period. The selection of a tax year is sometimes dictated by your legal structure. For instance, a C Corporation has no specific restrictions. However, S Corporations, sole proprietors and partnerships must usually follow a calendar year. Be sure to consult an expert before making a decision, since tax laws are subject to change.

THE RECORDKEEPING NEEDS OF YOUR BUSINESS MUST BE ANALYZED TO DETERMINE THE BEST BOOKKEEPING SYSTEM.

The second step is to select the method of accounting. The most common are the cash method and the accrual method. The cash method recognizes income and expenses when the cash is received or disbursed. It provides the most flexible means for deferring taxable income into future tax years. The accrual method recognizes income and expenses based on when income is earned or an obligation to pay a debt is incurred. It generally provides better matching of revenue and expenditures.

The method of accounting that will be best for you will be determined by your business operations. While these are the two most common methods of accounting, there are specialized methods that may be used in certain industries. You may want to consult a tax advisor to determine the best method for your business. Once a method of accounting is adopted on the initial tax return, it can be changed only with the permission of the IRS. Permission is usually granted if switching from the cash method to the accrual method, and routinely denied for the reverse, although recent developments have facilitated the accrual and cash change.

The proper accounting method and maintenance of your records will help:

- Correctly measure the profitability, growth and changes in your business
- Keep track of transactions with other businesses
- Supply present or future lenders with accurate financial information
- Support taxable income calculations
- Evaluate cash flows
- Provide reports on inventory turnover, return on capital, etc.
- Provide comparison with industry averages and regulatory reporting

There are two basic mistakes that many business owners make when setting up their bookkeeping. One, the owner doesn't understand the importance of proper records and ignores the need to establish a record keeping system. Such business owners tend to use the "shoebox method" as they allow receipts, invoices and bills to accumulate in boxes or piles. The second mistake is overkill. The owner invests in an expensive array of hardware and software to maintain his/her records that ends up being too complicated to use. This should not imply that computers are ineffective tools in a bookkeeping system. Rather, it is important to invest in a system that can be easily operated and that meets the needs of your business.

Monitor Your Cash Flow

Cash is absolutely critical to the growth and well being of your business. You must plan and prepare for all future events and market changes. The most important aspect of planning and bookkeeping is effective cash flow management. Failure to properly plan cash flow is a leading cause of business failure. Understanding your cash flow is important for five reasons.

- First, you will need cash to pay your fixed costs, such as rent, utilities, credit payments, etc.
- Second, most businesses have seasonal cycles. For example, a retail business will probably have increased sales around Christmas; however, this will require a build up in inventory in the fall when sales and cash flow may be slower. It is important to set aside funds for these changes in revenue and inventory.
- Third, it is important to save for long-term investment and capital purchases such as a new vehicle or a piece of equipment.
- Fourth, you must have cash available, or a sufficient line of credit, for all emergency situations.
- Fifth, pay attention to the impact of necessary tax payments.

Failure to properly plan for all five will damage both the short-term and long-term potential of your business. For example, you must frequently keep inventory on-hand in anticipation of potential clients or you must purchase supplies for a contracted project weeks or even months before you receive payment for these goods. While it is important to have the necessary cash available to pay your bills, regardless of when your clients pay you, excess cash may be an indication of "idle money" with a potential for a greater return if invested in another part of your business.

Credit Sales

Credit plays an important role in your cash flow - both the credit you receive from your suppliers and the credit you extend to your clients. If you do not pay your debts in a timely manner, it can reduce your access to credit in the future. Limiting your clients' ability to purchase on credit increases your short-term cash flow but may limit your customers' ability to make long-term larger purchases. A liberal credit policy can increase your sales. However, the increase in sales must be balanced against the cost of administering a credit program including collections and bad debts.

If you sell on credit, establish a credit policy and stick to it! It is important that your customers sign a contract or a credit application. State when interest will begin to accrue and disclose the specified interest rate and terms for balance due. Clearly disclose your right to sue or arbitrate in your home county. The contract should state that you are entitled to recover attorney fees and court costs.

Consider offering a discount for businesses that pay by cash or within x number of days of invoice. This may slightly reduce your revenue but will ultimately increase your cash flow as it encourages customers to pay in a more timely manner, and reduces the cost of administering your accounts receivable and the level of unpaid accounts.

You must register as a finance company if you extend credit to your non-business customers. Registration is completed through the Uniform Consumer Credit Code (UCCC), Colorado Office of the Attorney General, 1525 Sherman Street, 5th Floor, Denver, CO 80203, (303) 866-4494, Fax (303) 866-5691. Credit sales between two businesses are considered private contractual agreements and are not subject to the UCCC.

Credit cards are another alternative. You may be required to be in business for a period of time before you will be able to accept major credit cards. Banks normally process credit cards. Contact your bank for more information on credit card policies or for a referral to a credit card processing service. Credit card processors collect a fee for processing credit card payments, usually a percentage of the sale, which obviously reduces your cash flow. Take care to shop and compare the costs of these services.

Pricing and Sales Strategies

Your pricing strategy is an important part of your firm's cash flow and profitability. You must clearly understand your market, the competition and your customers to determine the proper price for your products or services. See the Marketing chapter of this Guide for more information. A common mistake is to simply track and focus all efforts towards increased sales. While this might appear to increase cash flow – be careful. If your customers purchase on credit, you may simply reduce inventory without any cash to replenish stock for the next customer. Another problem occurs when sales increase beyond your capacity to satisfy your customers in a timely fashion. As a result, your sales increase in the short term, but your customers are less likely to provide repeat business or give you positive referrals. Remember, more sales don't always equal more profit!

Who Should Keep the Records?

There are several options:

- **Keep Them Yourself:** This should be the choice if your business is extremely simple, has few employees, a single location, few products or services, and if it requires only a small part of your time or if you have a strong background in accounting principles.
- **Bookkeeper/Accountant Employee:** If your basic bookkeeping system is simple and you require few or infrequent financial reports, a bookkeeper may be all that you need. The more complex the needs of your business, the more likely you will require an accountant. Both bookkeepers and accountants can be hired as employees or independent contractors depending upon the type and amount of assistance desired/or needed
- **Bookkeeping/Accounting Services:** These services usually compile receipts, canceled checks and invoices, then process the data and prepare financial statements. This type of service is used when the business is more complex and requires a more sophisticated method for maintaining records, but can be cost effective when compared to an employee.
- **A Computer:** While a computer installed with a user-friendly bookkeeping computer program can be a very important and useful tool, it does not replace self-education or the services of a bookkeeper or accountant.

BOOKKEEPING VOCABULARY

Accounts Payable: A record of amounts owed by your business to creditors.

Accounts Receivable: A record of amounts owed to your business by customers.

Balance Sheet: A statement that states the balance in all accounts on a specific date.

Chart of Accounts: Serves as an index to the general ledger.

Fixed Ledger Assets: Contains records for all real and personal property owned by the business.

General Ledger: Contains balances of all accounts held by the business.

Income Statement: A statement that summarizes revenue and expenses for a specific period.

Journal and Cash Disbursements: A record of written checks.

Payroll Register: Summarizes payroll data, including wage withholding, FICA, and unemployment insurance taxes.

Purchases Journal: Includes information on materials purchased.

Sales and Cash Receipts: Used to record all incoming cash.

SELLING YOUR BUSINESS

All things, good and bad, eventually come to an end. Business owners choose to close and sell their businesses for a variety of reasons including: retirement, partnership disputes, boredom, illness or death, and lack of profitability. Selling your business will affect your income as well as your lifestyle. Closing and selling a business should be a planned event. Planning puts you in the leadership role.

Nearly every business uses accounting practices that will reduce the owner's tax liabilities. Unfortunately, the same practices also reduce the value of the business. Income is the principal factor in determining the value of a business. Whenever possible, plans to sell a business should begin three to five years prior to the actual sale. This will permit the time required to make necessary changes in accounting practices that demonstrate a record of maximum profits. Make certain that your financial records are accurate and presentable. Remember that CPA-prepared financial statements are a key tool in demonstrating the value of your business. Equally important as clean financial records are clean facilities and equipment. Be certain that inventory is properly stocked and current and that equipment is in working order.

Develop a comprehensive business presentation package for your business. This package is the business' resume and should include: a current business plan and valuation report, business history, operational and organizational outlines, description of facilities, review of market practices, personnel overview, explanation of insurance coverage, pending legal matters, and a compendium of 3 to 5 years of financial statements.

The valuation report should contain a professionally prepared appraisal, which will eliminate the guesswork of pricing your business. If you pick a price out of the air and do not have the profits, inventory and equipment to back it up, you will sell your business for less than its market value, or it will be overpriced and not sell. A professional business broker is also a resource for valuing your business based upon your industry and location.