**BUDGETING**

**Know Your Numbers**

Bookkeeping doesn't require that you hire an accountant or use bookkeeping software. If you can accurately state your income and expenses on your tax forms (and you've got the records necessary to prove that you're correct), you are good. But if you have employees, carry an inventory, have a large customer base, or incur substantial expenses, you need to institute standardized bookkeeping procedures, either on paper, or on a computer. Keeping good records will make your business more profitable by helping you:

* Recognize problems early (such as disappearing inventory, increased costs for products or equipment, or customers who aren't paying on time), before they have a chance to bring down your business.
* Maintain your cash flow at acceptable levels.
* Figure out whether it's time to raise (or lower) your prices.
* Put together the financial reports you need to get loans and investment, and
* Prepare your tax returns quickly and accurately.

**ACCOUNTING AND BOOKKEEPING**

What's the difference between accounting and bookkeeping? Accounting is the process of managing and forecasting a business's finances. An accountant advises a business and prepares financial reports. Bookkeeping is part of the accounting program; it refers only to the recording and maintenance of your financial records. A bookkeeper inputs information and keeps your accounts up to date.

**SOLUTIONS FOR NUMBER PHOBICS**

If you're an accounting novice and you've been dreading having to finally deal with business bookkeeping, don't worry. Even if you hid in the back of the algebra class, there are simple accounting solutions available to you. Here are three common approaches to bookkeeping.

***I don't want to deal with numbers (except to periodically review financial information).***

**Solution:**

Hire someone. If you're weak with numbers, too busy, or just don't want to think about it, hire a bookkeeper or accountant to handle your numbers. Go over your financials on a regular basis (monthly or quarterly) with your bookkeeper. By the way, accounting costs are tax deductible.

***I want to handle some of it and use an accountant for other tasks***

**Solution:**

Buy an accounting software program such as QuickBooks, Microsoft Accounting, or Peachtree Accounting. We'd recommend not installing the software yourself but instead have someone else install it—for example your bookkeeper, accountant or a qualified expert with knowledge of the specific program. That way you end up with the proper reports and charts customized for your accounts. These software programs also save you considerable time because you don't need to input credit card and banking information. Nowadays, banks and card providers allow you to download your financial data directly to your computer.

***I want to handle all of it.***

**Solution:**

If you want to do it all, we'd recommend one of the accounting programs mentioned above or a customized software accounting solution created for your business. Since you will also be preparing your own taxes, we recommend that you use a tax program that integrates with your software.

**BUDGETING AS A CONTROL TOOL**

A budget serves as a control tool to provide standards for evaluating performance.

A budget can cover any of the following:

* Profit planning – forecast of revenues and expenses
* Cash budgeting – forecast of cash needs and sources
* Balance sheet forecasting – anticipating future assets, liability and net worth position of the business

1. **PROFIT PLANNING (PRO-FORMA INCOME STATEMENT)**

The sales forecast and corresponding costs and expenses are the major inputs to a Profit Plan. Why is profit planning important? It enables the entrepreneur to see the complete picture and to analyse how each cost and expense item behaves in relation to changes in the level of sales. Budgeted amounts are then compared with actual results and variances are analysed and corrected.

1. **CASH BUDGETING**

A Cash Budget is used to determine anticipated cash inflows and outflows so that the business maintains the optimum level of cash (cash on hand being a non-earning asset). It also provides information on whether additional financing is required to address cash shortfalls.

The first step in preparing a Cash Budget is to list down all transactions having cash flow implications. For example, among the items included under Cash Receipts are collection of accounts receivable, cash sales, and proceeds of borrowings. Cash Disbursements, on the other hand, may include cash operating expenses, raw material purchases, equipment and other asset purchases, and repayments on bank loans (including interest). From this exercise, a Net Cash Balance is derived. This is then carried over to the next period (month or quarter, depending on the level of detail of the cash budget) as the beginning cash balance. Some businesses choose to have a pre-determined minimum required cash balance which they always maintain.

1. **BALANCE SHEET FORECASTING (PRO-FORMA BALANCE SHEET)**

This involves estimating asset levels to support the forecasted sales targets. For example, if the higher sales targets would necessitate opening more retail outlets, then necessarily, an investment in fixed assets is a must. Moreover, changes in the funding mix (i.e., a higher level of long-term loans vs. short-term borrowings) may also occur.

**BASICS OF ACCOUNTING PRINCIPLES TO GET STARTED**

There's no escaping it. You will have to grasp a few basic accounting terms in order to manage your business efficiently. Here are the basics.

**ASSETS AND LIABILITIES**

Assets and liabilities are the Yin and Yang of your business. Assets are your “pluses,” the things your business owns and is owed—for example, cash, real estate, inventory, accounts due, other property like patents or trademarks, and prepaid expenses—costs that are paid in advance such as taxes and insurance. Long-term assets such as buildings, equipment, or property that are not expected to be converted to cash are known as fixed assets.

Liabilities are your “minuses,” the business obligations or things that are owed—for example tax payments, repayments to investors, money owed to banks. Also included in the liabilities column—although they're not actually liabilities—are owners' equity (the amount invested by the owners in the business).

**How Does this Work- The Balance Sheet?**

How do assets and liabilities apply to your business? Assets and liabilities figure into several financial reports, most prominently, the balance sheet—a snapshot of your business at a given time. A balance sheet is commonly required when you seek funding or loans. It also gives you a snapshot of your business at any moment—think of it as taking your business's blood pressure. If you use a software accounting program, generating a balance sheet is just a matter of a few mouse clicks. A balance sheet adds up the assets and liabilities in two separate columns. As the name implies, the columns must balance, that is they should equal each other.

***Looking at a Balance Sheet***

A balance sheet is a snapshot in the life of your business—just one financial moment preserved. It's one of several financial report cards that a business prepares. Sometimes it's referred to as a “Statement of Financial Condition.”

**Equity and Debt**

Outside of sales revenue, the two common ways that cash comes into a business are equity and debt – investments and loans. Equity is the money or property invested and retained in the business by the owners (also sometimes referred to as ‘owners' equity'). If you don't properly track and account for equity, you will have tax problems and angry investors.

**Debt—** the loans, lines of credit and other borrowing you've done—refers to money that must be repaid usually with interest over a fixed period. If you don't properly manage debts the lender will foreclose on the loan, sometimes leading to a business bankruptcy.

**Accounts Receivable and Accounts Payable**

Accounts Receivable are amounts you are owed from sales of your products or services. Some retail businesses, since they receive payment immediately, have little or no accounts receivable. Accounts Payable are amounts you owe to vendors and suppliers, as well as any other short-term bills—for example payments for inventory, supplies or other goods or services. Loans and similar interest-bearing debts are not included in accounts payable.

Monitoring receivables and payables is a key element in cash flow management. As a rule, your cash flow is stretched the longer you must wait for your accounts receivables. Conversely, you'll generally have less cash on hand if you pay bills (accounts payable) before they are due.

**Income Statements**

In order to avoid the mistake of looking at a payment and guessing at your profit, you should use an income statement. An income statement provides a line by line breakdown of revenue and the various sums that are subtracted from the revenue to determine profit. (Most accounting software programs will generate similar statements of profitability.)

The top line in an income statement is the total sales revenue (or “gross income”). That's followed by the sales costs—the direct costs involved in producing the items that are sold (also known as cost of goods sold, CGS or COGS). For example, if you are a book publisher, these costs might be the costs of paper and printing or the costs to pay a writer to create the book. When you deduct the cost of goods from total sales revenue you get the “gross profit.”

**Your Operating Income**

The next lines are a series of operating expenses—for example: expenses associated with running your company, known as the general and administration costs (or “G&A”), and expenses associated with sales, marketing, and product development. When you subtract these operating expenses from your gross profit, you get your “operating income.”

A company next subtracts interest on debt and arrives at an amount referred to as its “income before taxes.” After taxes are subtracted, the income statement shows “net income from continuing operations,” and then finally, after subtracting all its expenses listed above and any one-time losses (for example, a legal judgment) from its total sales revenue—the final number is considered the “net income.”

**CASH FLOW STATEMENTS**

Some call it a cash flow statement, some call it a statement of cash flows and some just call it a cash statement, but no matter what it's called, the purpose is the same: to report your cash on hand and enable you to forecast your cash in the future.

A cash flow statement summarizes all the cash coming in and going out of a business during a specific period by analysing cash in three classes: operations (sales and operating expenses), financing activities (loans and equity), and investing activities (ownership of real estate, securities and non-operating assets).

But is a cash flow statement as helpful as it sounds? Cash flow statements can be difficult to understand at first, but once you have studied them, they become clearer. I know of several businesspeople that have a hard time, but explanations from their accountant, each time, at least for a couple of accounting periods, really helps.

***Deciphering Cash Flow Statements***

In other words, the challenge with cash flow statements—like many financial reports—is that they are troublesome to decipher. We recommend that you review monthly statements such as cash flow statements periodically with your bookkeeper or accountant. Once you understand how to read them you can efficiently get a pulse on the movement of cash, accounts receivable and bank balances.