Your First Critical Year In Business

Robert J. Clark

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Robert J. Clark – New Business QuickStart
New Business Owner Training Manual

Your First Critical Year In Business

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Preface

Every new business owner needs to understand small business survival basics. The adventure begins. This publication has been written to provide guidance on accounting and tax matters. It is targeted toward the small business with less than ten employees in the start-up phase. Education leads to success. The subject matter is intended to give the small business owner general knowledge about a subject, which will alert them to obtain more detailed information or seek professional assistance. I have gathered together subjects raised by small businesses over the years into a single source. The same subjects come up again and again and again. I am confident that a general understanding of each subject will help the new business owner progress in the survivability stage.

I address federal tax matters, which apply to all. For federal tax forms and instructions, I will be directing you to www.irs.gov. Click on Forms and Pubs, then List of current forms, then type the form number in Find. Each state has individual laws, fees, and registrations. I address typical state laws followed by many states. I will be directing you to the American Institute of Certified Public Accountants for links to state agencies. Go to www.aicpa.org, then click on Research, then external links. Taxes or registrations may also apply on the county

and municipality levels. You should contact those entities to determine requirements that pertain to you.

Entity Selection

Introduction

Before you actually start the business, you need to decide what type of tax entity you will select. This decision is not irreversible. There are procedures to change from one entity to another. You must decide if you will own this business yourself or if the business will have multiple owners. Again, this decision is not irreversible. You must decide whether the nature of your business or personal attitude requires limiting liability. You must decide which entity taxation and benefits deductibility best meets your situation. You must understand that the tax people will receive their taxes no matter which entity you select. You must understand that no one entity is head and shoulders better than the others. Otherwise, every business would be structured the same. This is not the case. The entity you select should be selected based upon your personal preferences and personal tax structure.

You Have a Partner – The Government

No matter what type of entity you select, the government has a tax structure in effect to make sure they collect their taxes. You most likely have worked for

someone and received a paycheck. Did you ever get to take the gross amount home? No. The government deducted their taxes before you got to take home your net pay. What came out of your pay? The following is a summary of typical deductions:

Federal withholding tax	15.00%
Social Security	6.20%
Medicare	1.45%
State withholding	2.00%
State unemployment/disability	1.00%

And then the company matched:	
Social Security	6.20%
Medicare	1.45%
Total taxes	33.30%

You have a one-third partner in the government. You need to accept this fact. You need to include this fact in pricing. You need to start saving and paying taxes when you make it. Do not wait until you file your first business income tax return on April 15th next year. The biggest reason I see businesses going out of business is not providing for taxes during the first critical year. They get their hands on tax money that they were never able to touch before. They build the new deck on the house they always wanted. Then on April 15th, they owe the 33% taxes from last year during this year, as well as having to pay the 33% for this year. The 66% tax in one year puts them out of business.

If you need to take home $40,000, you need to gross $60,000 for yourself and set aside $20,000 for taxes. In this example, multiply your draw by 50% to determine estimated taxes.

If you take home a gross of $60,000, multiply by 33% to determine the government's share.

Start setting aside taxes from day one, no matter what entity type you select. Not providing for taxes will put you out of business.

WARNING: The above 33% is just a guideline. Your actual rate may be higher or lower.

Proprietorships and Partnerships

The first decision in selecting an entity is to decide if you are going to establish this business alone or with other individuals.

If you do it alone, you make all the decisions, reap all the rewards, and incur all the initial costs. If you do it with others, you segregate responsibilities, share the rewards, and share the initial costs. Setting up with others creates other factors that will need to be documented such as:

What happens if one partner works 40 hours a week and the other does not work?

What happens if one partner puts in all the initial money and the other has no money?

What happens if one partner should want to leave?

What happens if one partner should die?

What happens if one partner should become disabled?

What is the Partnership value in these circumstances?

It is not enough in a Partnership simply to shake hands and say we share everything 50/50. Just because your partner is a relative does not change the situation. You need a Partnership Agreement if you elect to have a partner.

The first hat you need to put on when you start a business is a salesman's hat. If you do not have customers, you do not have a business. It is imperative to evaluate your own ability. If you are a production person, hesitant in selling, you may be wise to partner with a salesman hesitant in producing. Two salesmen may make large initial sales, but can't deliver the product or service. Two production people may have super-efficient ways to deliver the product, but no customers to deliver it to. One person responsible for sales and one person responsible for production is usually the better combination.

In a Partnership, it is imperative that a listing of responsibilities be assigned to each partner. It is imperative that each partner allows the other partner to do his assigned tasks without interfering.

Time is your most valuable asset. The successful business owner finds a balance between business, family and self. Yes, as a business owner, you will work longer hours than an employee. However, you cannot spend 80 hours a week on business. Neglecting the family can lead to divorce which often leads to the end of the business. Find your balance between work, family and self. Establish a workable policy; I don't work Sundays, I go home to eat dinner with the family, I play golf once a week, etc. The person who gets the right balance improves their chances for success.

Have you decided to go it alone? You have decided to be a Proprietorship. Have you decided to establish the business with others? You have decided to be a Partnership.

But, not so fast! You need to ask yourself the next question. Am I concerned about losing my personal residence and personal investments?

Corporation and Limited Liability Companies

Every business entity, right from the startup phase, should have liability insurance. In the event you do something to cause damage or personal injury, you need to have insurance to cover the liability. This liability is usually limited to a certain dollar amount. What happens if you are found negligent beyond that amount? First, they will come after the business assets. If there are not enough business assets, the next step is to go after your personal assets including your personal residence and personal savings.

You could be a painter using a new chemical brush cleaner. It spills down the drain and goes into the local river. The crabs become contaminated. People eat the crabs and 100 die. They trace it back to your negligent act. A $100,000,000 judgment is filed against you. They take what they can and a judgment against your business and you personally are filed and continue on record. Three years later, you win a multi-state lottery for $75,000,000. Who do you think will get the money?

If you deal with toxic chemicals, cars or trucks across the road, airplanes, boats, heavy equipment, etc., you are in a dangerous industry and should consider ways to limit your liability.

If you are in roofing, electrical, plumbing, home construction, siding, etc., the potential for lawsuits is less, but personal injury occurs and you should consider ways to limit your liability.

If you are in bookkeeping, secretarial, retail, food service, etc., the potential for lawsuits is lower, however, you should consider ways to limit your liability.

Many people simply do not want to take the chance that a business could result in a lien against their home or personal assets. If that is your case, you should limit your liability.

Limiting your liability simply means that in the event of a judgment against your business, they can go after the business assets, but not your personal assets.

At this point, you need to understand personal guarantees. If your business borrows money from a bank, they most likely will make you sign personally on the debt. If you rent business property, the lease may require a personal guarantee. If you have a business credit card, they probably required you to sign personally. Other business owners understand the limited liability structure and will require your personal guarantee to circumvent limited liability. If you want the loan, you will have to sign personally. The real benefit of limited liability is the result of judgment against the business for an unforeseen circumstance.

To limit your liability to business assets, you should set up either a Corporation or Limited Liability Company.

A Corporation is a totally separate entity from you. The Corporation issues you corporation common stock and you become a stockholder. The company can issue the stock to only one person or to more than one person. The stockholders appoint a board of directors. The board of directors appoints the company officers that run the company. A single person can be the only stockholder, the only board member, the only company officer and the only employee. The Corporation files a corporation income tax return and pays taxes based on corporation tax rates. The Corporation gives you a W-2 for wages paid you and a 1099 for dividends paid you (small businesses do not normally issue dividends). You report the salary and dividends on your personal return.

A Limited Liability Company (LLC) does not have the formal structure of a Corporation. It functions as a Proprietorship or Partnership, but with the benefit of limited liability. A single owner LLC files a business income Schedule C as an attachment to their personal return. A multi-owner LLC files a Partnership

income tax return but does not pay tax. Each partner receives a K-1 that tells him how much to report on his personal returns. Each member of the LLC pays quarterly estimated taxes.

People are familiar with being employees. When you make $750 per week, you never get to take home the full amount. You receive a net check of say $500. Your company sends your taxes to the government. The only money you had a possibility of spending was the after tax dollars.

The biggest problem with businesses going out of business is not providing for the first year income taxes. In selecting the corporation structure, you become an employee and only get to spend the net check. Your personal lifestyle does not change. The Corporation sends in the taxes every month.

As an LLC (as well as a Proprietorship or Partnership), you get your gross pay and you are expected to send your taxes into the government each quarter. Instead of receiving the $500 net check, you get your hands on the $750. Too often, new business owners spend the $250 tax money on a new deck, business equipment or some item other than taxes. You get to the end of the quarter and the $3,250 ($250 X 13 weeks), required to be sent in, is not paid. You get to the end of the year and file your tax return. You now owe last year's taxes plus, this year's taxes. You are out of business.

If you do not have the discipline to save and pay the taxes, then you have a better chance of survival by being a Corporation.

If you have the discipline to save money and want a less structured approach, you can choose a Limited Liability Company.

If you expect to carry receivables, inventory or have a large equipment need, which requires that cash be retained in the business, corporation tax rates on profits are most likely less than personal taxes. A Corporation is probably your right choice.

If you are a doctor, lawyer, accountant, consultant, etc., you are subject to personal service corporation rules. Your corporation tax rates are most likely higher than personal tax rates. An LLC is probably your right choice.

As a Corporation, you can have a corporation year-end other than December 31st. An LLC (Proprietorship or Partnership) requires a December 31st year-end. Having the Corporation with one-year end and the personal with another, helps in tax planning.

In a Corporation, group health insurance and other benefit programs, including yours, are 100% deductible. As an LLC (Proprietorship or Partnership), the deduction for you is limited. If you need benefits, consider the Corporation structure.

The Corporation structure requires you to be an employee with payroll deductions. You can have a fiscal rather than a calendar year-end. You can fully deduct health insurance and other benefits. For non-professionals, corporation tax rates on the first $50,000 in profits are usually lower than personal tax rates.

The LLC structure does not require the owner to be on a payroll. Your business year-end must be December 31st. Deductions for health insurance and other benefits may be limited.

S-Corporation

When you set up a Corporation, it is not automatically an S-Corporation. We differentiate the regular corporation above as a C-Corporation. To become an S-Corporation, you must register with the federal and state governments. The S-Corporation is an election to have the corporation profits reported on your personal return and to pay taxes at personal rates rather than corporate rates. You are still an employee. However, certain expenses for benefits are not deductible on the corporation but, passed through and reported on the personal return.

The S-Corporation has the tax discipline of the owner being an employee, but the taxability of profits as an LLC (Proprietorship or Partnership).

One Shoe Does Not Fit All

If one structure was right for everyone, we would all be Corporations, Limited Liability Companies, Proprietorships, or Partnerships.

Most small businesses start off as Proprietorships or Partnerships and, as they feel they will survive, convert to Corporations, S-Corporations or LLCs.

If you are in a dangerous industry or have any concern about personal liability, you should incorporate or establish an LLC.

If you want limited liability, the discipline of employee status for taxes, health benefits, and are not a professional, C-Corporation status may be the most appropriate.

If you are a professional, want limited liability, and the discipline of employee status, S-Corporation status may be the most appropriate.

If you are a professional, want limited liability, and do not want your structure to be employee, LLC may be the most appropriate.

If you want limited liability and expect recurring losses, an S-Corporation or LLC may be the most appropriate.

Selecting the right entity is not an easy decision. It is always appropriate to have a professional review your exact set of circumstances.

If you made or make the wrong decision, you can always change it in the future.

Setting Up Your Proprietorship or Partnership

You set up your Proprietorship or Partnership on the local municipal level or county level depending on your state. Your can do it yourself at the municipal clerk or county clerk office. You review name availability, fill out a form, and pay

a fee. You then receive a trade name or doing business as certificate. It is not that hard to do it yourself. You need this certificate before opening a bank account, getting an IRS number, registering with your state taxation agency, or registering for local requirements.

Setting Up Your Corporation or LLC

You set up your Corporation or Limited Liability Company at the state level through the Secretary of State office. You can do it yourself by going to your state website, checking for name availability, completing a registration form, and making a fee payment to the state. The state will provide you a certificate of formation as a Limited Liability Company or a Corporation. It is not that hard to do it yourself. Go to www.aicpa.org. Click on research, external links, Secretaries of State. You need this certificate before opening a bank account, getting an IRS number, registering with your state taxation agency, or registering for local requirements.

Using a Website to Assist You

Again, I want to say it is not that hard to set up your own business entity. However, if you google "form an LLC" on page one I found nine websites providing this service. With this many websites it just may be harder than I think for most people. All these websites have you decide if you want to be a Corporation or a Limited Liability Company. They then have you provide them the information they need to put onto the state forms. They file the forms for

you. You pay them a fee plus the state filing fee. This certainly sounds simple. It gets complex the way they add additional services and price package those services.

In Connecticut I recently formed an LLC. Since I lived in Connecticut and had a Connecticut address I was able to make myself the registered agent who receives all notices from the state. To change the registered agent, I would need to file a change form and pay a fee. Many of the pricing packages include registered agent service even if you could serve as your own registered agent. This could lead to a fee to change to yourself or an annual fee for the website to continue as registered agent another year.

If you do use a website recognize that their lowest level service will legally form your LLC or Corporation. Before ordering any higher cost services make sure you understand what you are getting.

Business Name

When a person sees your business name they should know who you are and what you do. There is a major difference between John Doe LLC and John Doe Plumbing LLC. There is a major difference between Doe Contracting and Doe Home Builders. Think about your business name before you register your business. You can change your name after forming your LLC or Corporation. You will need to go back to the Secretary of State and file a name change and pay a fee.

For more resources visit www.rjclark.com.

Registrations

Federal Registration

After you have decided on the type entity and established it, the next step is to determine if you need to register with the Internal Revenue Service. If you are going to have employees, you must register. If you are a partnership, any type corporation, or a limited liability company, you must register. If you are a proprietorship without employees, you can use your social security number provided your business name and your name are the same. If not, you must register.

You use form SS-4 to apply for a federal identification number. For a copy of the form and instructions go to www.irs.gov. Click on Forms and Pubs, then List of current forms. Enter SS-4 in find. Most of the information is self-explanatory. Make yourself the responsible party. Under type of entity mark Sole Proprietor if you are a sole proprietor or a single member LLC. Mark Partnership if you are a partnership or a multiple member LLC. Mark Corporation if you have incorporated or if you are any LLC which has elected to be taxed as a

corporation. You will be filing corporation taxes on form 1120. If you are not a C Corporation, your year-end should be December 31. If you had a previous business identification number for a different business, answer no to this question.

Once you have completed the form, now you need to file it. You can send it in by mail or fax but for immediate response you should do it online. (Go to www.irs.gov. In search type EIN). The information is basically the same as on the SS-4 paper form. You will obtain your ID at the end of the online process.

State Registration

There are 50 different states with 50 different laws. Just because you registered your LLC or Corporation with your Secretary of State office, it did not register you for payroll taxes and sales taxes. In addition, there may be special state taxes for selling gasoline, cigarettes, liquor, etc. Certain occupations may be subject to registration such as accountants, contractors, plumbers, etc. Start with your state website and find registering your business usually under the Department of Revenue. Each state will have a starting your business area. Visit www.aicpa.org. Click on research and then external links. Go to Department of Revenue, Department of Labor, and Sales Tax.

Local Registration

You should also contact the county clerk in the county where your business is located. If your business is a proprietor and is using a name other than your

name, you will most likely have to register a trade name. In addition, you may require county health inspections or other county level requirements.

Your next stop should be the municipal clerk's office in the town where your business will be located. You may need a merchant's license or other registrations.

Trademarks and Service Marks

I am sure you have seen the symbols ® and ™. Basically. If you have a slogan or logo, which you wish to safeguard, you need to register it. The first level is usually at the state. You would normally register unique marketing tools, which you do not want anyone else to use. Contact your local state office to determine how to register your trademarks and service marks.

Trade Associations

Do not remake the wheel. There are trade associations for almost any type business. Join one and reap the benefits. These associations can help you with pricing and structure. In addition, they usually have made arrangements for liability, health, disability, and other industry specific insurance programs. I cannot overstate the importance to your success that your trade organization will provide. Search the web or ask some others in your industry to find your trade association.

Chamber of Commerce

This organization is a must as your first line on face to face marketing. Get active in their events and get to know the owners of the local businesses. This is where your networking begins.

Web Presence

To operate in the business arena today you need to have at least a domain name, a website, an email address, and a social media account. All should be in the business name not a personal social media account. I suggest starting your social media with LinkedIn if your referrals come from other business owners and Facebook if your customers contact you direct. Doing both will not hurt. You also need to understand SEO (Search Engine Optimization) and AdWords marketing. If you google websites, you will find a group that can help you with all the above.

For more resources visit www.rjclark.com.

Bookkeeping Basics

Business Checking Account

You will need your business identification number before opening your business checking account. The backbone of the bookkeeping record is a business checking account. In most instances the bank will not open up a business checking account without a copy of the trade name registration, articles of incorporation, LLC, or partnership papers. You should open a business checking account and not a personal checking account. You should open the account in a commercial bank that works with small business owners. You should order business checks, not personal checks.

Business Is Business

It is extremely important to segregate your business activity from your personal activity. It is very common for the business owner to start a business using their personal checkbook or to open a business account and then write checks out of the personal account when there is not enough money in the business account.

The rule is that business is business and personal is personal. No business income gets deposited in the personal account. No business expenses get paid from the personal account. If you need money in the business account, transfer funds from the personal account and clearly designate them as loans from you to be repaid.

Deposit All Funds

Just because someone pays you in cash is no reason not to deposit the cash in your business checking account. Later on you will understand that for each dollar you do not deposit, your income is reduced by that dollar, and your borrowing capabilities whether personal or business is reduced by four dollars. Most businesses that do not deposit cash received from customers are not managing their businesses properly and are usually the businesses that do not survive. It is also just a matter of time before taxing agencies receive some type of flag. In that case they go back not only to this year but retroactive for three years and sometimes more. I have seen what appeared to be successful businesses fail to survive. You can only improve your chances of survival by depositing all customer funds received. It is better to make a dollar and pay the government forty cents than to not have made the dollar at all.

All Disbursements by Check

The first rule is: if you can write out a check or make an electronic bank payment with a company or individual's name on it, that's what you should do. If you need stamps, write out a check to Postmaster. Go to the post office, get stamps,

and give them the check. I do not care if you get a receipt. In an audit your check went to a third party. There is no doubt you did not receive these funds. Now, let's do the same transaction differently. You write out a check to cash. You cash the check. You take the cash to the post office. You get the stamps and a receipt. You put the receipt in your receipt shoebox. In an audit they will say the check to cash went to you. It is not a good deduction. As far as the receipt in the shoebox, they will say you could have picked it up off of the floor. In addition, with computers you can make real looking vendor invoices. There is no doubt about the deduction if there is a check or electronic bank payment to a vendor. Do not make any checks payable to cash. Do not use cash to pay for anything. Use a check or electronic bank payment to pay bills with a business or individual name on the check or electronic payment.

The second rule is: If you cannot use a check or bank electronic payment, use a business credit card, and then pay the business credit card by check. I said a credit card, not a debit card. Debit cards cause multiple problems. You forget to record them in the checkbook. They do not always come in on the bank statement in the same name as the store. Reconciling the bank account is more complex. A credit card has one checkbook entry and one reconciling item. I strongly recommend not using debit cards or ATM withdrawals in your business account. Again, if you cannot use a check or electronic payment, the second alternative should be to use a credit card, and then pay the credit card by check. The credit card does not necessarily have to be in the business name but I would strongly recommend it. You can use a personal credit card but use it strictly for business. Have another credit card you only use for non-business items. We want a business name on the credit card so that we can build business credit under the Federal ID number.

The third rule is: If you cannot pay by check or credit card, maintain an expense record, and write yourself a monthly expense reimbursement check. Going to the bank to make a deposit is a business expense. You need to get a log to keep in your car and start tracking business mileage. You decide to go to a trade show. You drive your car, pay tolls, and take a ferry. In addition, you want to buy a book at the show but you do not have a check and they do not take credits cards. You pay with cash. Put the mileage at IRS allowed rates and the cash payouts on your monthly expense report, submit it to your company, and get back a check. The payment is deductible to the company but not included in your income. If you do this each month you will not be running around at tax time to get these deductions and they will not just be forgotten. Again, if you cannot pay an expense with a check or put it on a credit card, then keep track of it, submit a monthly expense report, and receive a reimbursement check.

If you follow these three rules, your bookkeeping will be very organized.

Manual Checkbooks

You will need to have a manual checkbook even if you computerize your accounting. If your accounting is computerized, you will use your manual checks in an emergency or when on the road. These will then be put into the computer system. In this instance a simple business checkbook similar to a personal checkbook is sufficient.

If your accounting is not computerized, you need a more detailed manual checkbook. You will need to account for vendor checks as well as payroll checks. The standard business checkbook consists of three checks on the right with stubs on the left. In this system, you write out the check and then record the same information on the stub. If it is a payroll check, you need to record the payroll gross to net on an employee earnings card. This process consists of writing the same information three times: on the check, on the stub, and on the earnings record. Transpositions and other errors can occur. I recommend what is referred to as combination payroll and disbursements one-write systems. This system consists of a journal, which goes on a board. The checks go over the journals. The employee earnings card goes under the check. You write the check, it goes on the employee earnings card, and goes on the journal all at one time. This process will make your bookkeeping easy and your accountant will receive good records. Not all small companies computerize their accounting. If you do not feel comfortable computerizing, a one write manual system will work just fine.

Chart of Accounts

As you write out checks you need a system to summarize all like checks together. We need a way to accumulate all the telephone bills paid during the year into one number for tax returns and financial reports. This is done using a one write manual system in one of two ways. First, you can spread the checks to various columns, one designated as telephone. Second, you can have one column in which you use a code number, which designates telephone. I prefer the second method, which will work well with your accountant who will summarize this data into his computer system. The idea is that you have a chart of accounts. As you write out a check you tell the accountant what this expense is for (telephone) by

recording on the journal the account number for telephone. The following is a startup Chart of Accounts for a sole proprietor or a single member LLC which coincides with the lines on Schedule C, business income, which you will need to complete for inclusion in your personal income tax return.

Balance Sheet

Assets

1100	Cash Checking
1200	Accounts Receivable
1300	Inventory
1400	Other Current Assets
1500	Property and Equipment
1600	Accumulated Depreciation

Liabilities

2100	Accounts Payable
2200	Credit Card Payable
2300	Taxes Payable
2400	Other Current Liabilities
2600	Loans Payable
2800	Other Liabilities

Equity

3100	Owner Equity
3200	Owner Draw

Income Statement

Income

4100	Sales

Cost of Sales

5100 Purchases

5200 Labor

5300 Subcontractors

5900 Other Direct Costs

Expenses

6100 Advertising

6110 Car Expenses

6120 Commissions and Fees

6130 Depreciation

6140 Employee Benefits

6150 Insurance

6160 Interest

6170 Legal and Accounting

6180 Office Expense

6190 Pension and Profit Sharing

6200 Rent Expense

6210 Repairs and Maintenance

6220 Taxes and License

6230 Travel Expense

6240 Meals and Entertainment

6250 Utilities

6400 Office Salary

6500 Other Expenses

Monthly Bank Account and Credit Card Reconciliation

Time is the business owner's most valuable asset. One of the first controls to go seems to be taking the time to reconcile the bank statement each and every month. Unless you agree the cash balance in your journals to the cash balance on your bank statement, your bookkeeping will be incomplete. First, make sure the bank is cutting off your statement on the last day of each month. If they are not, request them to do so. Second, reconcile your month end bank balance to your month end journal balance. If you follow the bank procedure you will be reconciling to the journal balance the day you receive the bank statement. Doing this gives us no assurance that the month end balance is 100% correct. To reconcile your account first look for any deposits you recorded during the month which do not appear on the bank statement. Add these to the bank balance. Look for any checks you recorded which have not been processed by the bank. Subtract these from the bank balance. Look for any service charges, debit memos, or credit memos, which you have not recorded. Record these in your journal for the month being reconciled. The reconciliation balance should now agree with your journal balance. If not, check for math errors. It must reconcile. Everything mentioned above also applies to your credit card statement. Warning: Waiting until the end of the month to download bank and credit card information into accounting software can cause bounced checks and double recording of transactions. Be careful using this technique.

Accounts Receivable Control

The simplest way to control your receivables is to set up a folder for unpaid customer invoices. Every time you send a customer a sales invoice, put it in this folder. When you receive payment, take the invoice out of this folder. Record the payment check number and amount, and file the paid invoice in a paid invoice folder alphabetically. At the end of each month take your unpaid folder and make a list of the invoices unpaid. This represents your month end accounts receivable.

Accounts Payable Control

The simplest way to control payables is to set up a folder for unpaid vendor bills. Every time you receive a new vendor bill put it into this folder. Select the bills to be paid, write out the check, and record on the vendor bill the check number, date and amount paid. File the paid bill in a paid vendor invoice file alphabetically. At the end of each month, make a list of all your unpaid vendor bills. This represents your month end accounts payable.

Payroll Control

At the end of each month you need to summarize the employee earnings cards for each employee. You then need to summarize these totals into a grand total for all employees for the month. From here you will be able to determine the total federal and state payroll taxes that need to be deposited.

Coordinating with Your Accountant

A properly set up one write system will give you the means to determine your monthly payroll and sales tax deposits. Normally, you would make these deposits. At the end of each calendar quarter, federal and state payroll returns are due. Usually, the accountant will handle these filings. You give the accountant your journals for the quarter, employee earnings cards, bank statements and cancelled checks, bank account reconciliation, a listing of unpaid customer invoices, and a listing of unpaid vendor bills. With this the accountant will have everything he needs to prepare payroll tax returns, sales tax returns, W2s, 1099s, business income tax returns, general ledgers, and financial reports. Accountants have many variations of these procedures including accounting software alternatives. Check with your accountant to coordinate with his procedures.

For more resources visit www.rjclark.com.

Accounting Software

Overview

Computerizing your accounting is absolutely the most efficient way to handle your bookkeeping tasks. Partly computerizing your accounting is probably the least efficient way to handle your bookkeeping. You do not want to send out computerized sales invoices, use a payroll service to do your paychecks, and pay vendors with manual checks. This variety of procedures causes havoc. Have a complete manual bookkeeping system or a complete computerized bookkeeping system.

Accounting software for small business comes in two alternatives, entry level or mid-range. The entry-level software is designed for up to about ten employees whereas the mid-range can handle companies up to about 100 employees. They both print customer invoices, track vendor bills, and make gross to net pay computations, as well as produce financial reports. Entry-level software costs from $100 to $500 for a complete system. Mid-range costs $5000 to $15000 for a complete system. The big difference is in the number of transactions that can

be handled and the speed in handling those transactions. Most small businesses will find that entry-level software will work just fine.

Today there are two alternative for accounting software. First is a product where the software and your data files are on a computer in your office. Your accountant can come to your office, you can provide him printed data, or he can remote access your computer. Second is a product where the software and your data are on a server in the software company office which you access through an internet connection from your office. The second alternative is the one I recommend. It allows you, your employees, and your accountant simultaneous access to your data from anywhere, twenty-four hours a day, seven days a week. In addition, I feel the software company servers are less likely to corrupt data and less likely to be vulnerable to hacking. You may not agree and feel data on your computer is under better control. If so, use a desk top version rather than a cloud version. Both work.

It is not just a matter of going out and buying the software. That does not make your system up and operational. First comes installation and registration of the software including registering for payroll tables to compute gross to net pay. This is usually an additional annual fee. Next comes configuration. This is telling the software how to perform its functions in the manner that you do business. For example, you need to set it up for your state payroll and sales tax laws. After configuration comes record transition. This is getting your customers, vendors, employees, and opening numbers into the system properly. Next comes operator training. You need to understand how to produce customer invoices, record vendor bills, pay employees, etc. You then need to develop procedure documentation for daily, weekly, monthly, quarterly, and annual routines. The

final piece of the puzzle is to have a source of on-going support as needed. Computerizing your accounting is a much larger commitment than just going out and buying the software. If you need help don't be afraid to use it. Look at any cost of getting the system up and operational as a five-year investment and not as an expense today. Being computerized is the best and least expensive way to coordinate with your accountant and, accordingly, the initial cost may be saved in reduced fees.

Accounting software does not make you an accountant or even a qualified bookkeeper. Just because you can print out a customer invoice does not mean you understand the debits and credits that occurred. Just because you can print out a quarterly payroll tax return does not mean it is correct. The accounting software is a powerful tool, which can help you and your accountant in a joint effort keep the company records accurate.

The Primary Modules

A computerized accounting system has four primary modules; accounts receivable, accounts payable, payroll and general ledger.

The accounts receivable module tracks customer activities. You prepare customer invoices. This records the sales and sets up a receivable from your customer. You receive customer payments. This records the cash received and reduces the receivable due from your customer. This module tracks what customers owe you, assesses finance charges, and allows you to send customer statements.

The accounts payable module tracks vendor activities. You record vendor bills when received. This recognizes your expense and sets up a payable to your vendor. You write out checks to pay vendors. This records the decrease in cash as well as the decrease in payables due to vendors. The module tracks what you owe vendors and tracks cumulative amounts paid to certain vendors for form 1099 issuance.

The payroll module tracks employee activity. It computes gross to net paychecks and prints them. This increases your payroll expense and uses your cash. The module tracks amounts needed to pay payroll taxes. This increases payroll tax expense and uses your cash. It tracks individual cumulative earnings for each employee. This information is used on quarterly payroll tax returns and annual W2s.

The general ledger module tracks all the activity of the receivables, payables, and payroll modules. Each sales invoice, customer payment, vendor bill, vendor check, and payroll check gets posted into a general ledger. You then make corrections to the general ledger for depreciation, bank charges, etc., by making journal entries. The ending balances in each account are summarized into a trial balance. From the trial balance the asset, liability, and equity accounts are summarized into a balance sheet. The income and expense accounts are summarized into a profit and loss statement. This module usually includes a bank account reconciliation function.

The Secondary Modules

The inventory control module is used in retail, wholesale, and manufacturing to

track goods available for sale. When you receive a vendor bill, you record it as a payable to the vendor in the accounts payable module. If that bill is for saleable product that you wish to track, you record the individual line items in inventory item accounts. The transaction increases inventory and increases accounts payable. When you prepare a customer invoice, the invoice shows the individual items sold. This results in one transaction, which increases receivables and increases sales, and, another transaction that decreases inventory and increases an expense account cost of sales. This module tracks the inventory you have on hand.

The purchase order module tracks inventory that has been ordered but not yet received. It can usually determine minimum inventory levels of each item as well as order quantities. You produce a purchase order. It notes in the inventory item the amount on order. When the vendor bill and items are received, the purchase order is updated to a vendor bill.

The sales order module tracks inventory that a customer has ordered but has not yet been shipped. When it is shipped, the sales order becomes the customer invoice.

The job cost module is used by any company that needs to know profitability by job. This module usually allows an estimate to be prepared. As vendor bills are recorded in accounts payable, they are also charged to a particular job. As employees work on jobs they track time. When payroll checks are prepared they are also charged to the jobs. When sales invoices are sent, they are charged to the jobs. At any time, you can track estimated verses actual by job.

Industry Specific Applications

Lawyers and accountants track and bill clients based on time. They use time billing software. Doctors bill insurance companies for patients. They should use medical billing software from the start. Manufacturing companies need to track raw materials into work in process and then into finished goods. Retailers may want to use scanning equipment for point of sales applications. There are a wide variety of industry specific applications.

Conclusion

For most start-up businesses entry-level software is where to start. This will handle 95% of your needs. However, some industries, like medical, require specific software. Doctors can use medical billing software for their accounts receivable functions. They can also utilize lower cost entry level for their payables, payroll, and general ledger functions. Check with your industry associations. They will have recommendations for your business. I feel strongly that cloud based entry level software is where you should start.

For more resources visit www.rjclark.com.

Income Taxation

The Proprietorship

If you decided to set your business up as a proprietorship, the reporting of business income less business expenses becomes part of your personal income tax return. You will need to complete form 1040 Schedule C. For a copy of the form and instructions go to www.irs.gov. Click on Forms and Pubs, then List of current forms. Enter 1040 (Schedule C). In a proprietorship you are not on a payroll. If you have other employees, you need to set them up as employees with tax deductions but not yourself. You remove money from the proprietorship for personal needs by taking a draw check. Using our prior example that you have the government as at least a one-third partner, then for every $300 you draw you need to send the government $100. For the proprietor this is sent in every quarter with a form 1040-ES transmittal**.** For a copy of the form and instructions go to www.irs.gov. Click on Forms and Pubs, then List of current forms. Enter 1040-ES. You will have a similar procedure for your state. The 1040-ES is due April 15, June 15, September 15, and January 15. On the personal return you not only have to pay income tax but also self-employment tax (Social Security/Medicare).

This is reported by attaching form 1040-SE to your return. You report the amounts paid with the 1040-ES form on page 2 of form 1040 under estimated taxes. For a copy of the forms and instructions go to www.irs.gov. Click on Forms and Pubs, then List of current forms. Enter 1040 (Schedule SE) and then 1040.

The Partnership

If you decided to set up your business as a partnership, the reporting of business income less business expense is done on a partnership income tax form. You will need to complete form 1065. Partners are normally not set up as employees. The partnership income is allocated to the partners and each partner receives a K-1 form telling them what to report on their personal tax return form 1040 schedule E. For a copy of the form and instructions go to www.irs.gov. Click on Forms and Pubs, then List of current forms. Enter 1065 and then 1065 (Schedule K-1) and then 1040 (Schedule E). Partner income is subject to both income tax and self-employment tax. They make estimated quarterly payments using form 1040-ES. Similar state returns are required.

The Limited Liability Company

A single member LLC is considered a proprietorship and, accordingly, follows the proprietorship rules above. An LLC with more than one member is considered a partnership and, accordingly, follows the partnership rules above. In addition, an LLC may make an election to be taxed as a corporation

The C-Corporation

If you elected to set up your business as a standard corporation, the reporting of business income less business expense is done on a corporation income tax return. You will need to complete form 1120. For a copy of the form and instructions go to www.irs.gov. Click on Forms and Pubs, then List of current forms. Enter 1120. The owners would be on a salary and receive a W2. The tax on profits of the corporation are paid by the corporation and are not reportable on the personal tax return. Similar state filings are required. After tax income is retained by the corporation. Any dividend distributions are not deductible to the corporation but are taxable on the personal return. Any distributions closing the corporation are not deductible to the corporation but are taxable on the personal return.

The S-Corporation

If you decided to setup your business as an S-Corporation, you filed for an S-election on form 2553. The reporting of business income less expense is done on an S-Corporation income tax return. You will need to complete form 1120S. For a copy of the forms and instructions go to www.irs.gov. Click on Forms and Pubs, then List of current forms. Enter 2553 and then 1120S. Since a corporation is considered a separate entity from the owners, you receive your compensation in the form of a deductible salary. The corporation will give you a W2 form to report your salary on your personal return form 1040. The election to be an S-Corporation was made so that the profits of the corporation would be taxed at personal tax rates instead of corporate tax rates. Accordingly, just like partners, the stockholders in an S- Corp receive a K-1 to report their pro rata share of the

S-Corp income on 1040 schedule E. They make estimated quarterly tax payments on this income using form 1040-ES. Similar state forms are required. Assuming the stockholder salary is reasonable, the taxable K-1 amount is subject to income tax but not to self-employment tax.

Corporation Versus Individual Tax Rate

The more income you make personally, the higher your income tax rate on form 1040. As your business adds to your personal income, the lowest corporation rates may provide less total tax. Many individuals will start with an LLC and as their profit rises change to a corporate structure. You need to monitor this possibility at least annually.

For more resources visit www.rjclark.com.

Sales Taxation

Sales Tax

Sales tax is a state tax and, accordingly, there are different laws for each state. For information related to your state go to www.aicpa.org. Click on research, then external links, then sales tax. Not every state taxes every product or service. In most states a computer will be subject to tax but a doctor visit will not. In some states clothing is subject to tax but in other states it is not. Non-carbonated bottled water may not be subject to tax but carbonated bottled water is subject to tax. Some items may be subject to tax at the wholesale level and some at the retail level. First you need to know what items in your state are subject to tax. Then you apply the appropriate sales tax rate to that item to determine the amount of tax to add to a customer invoice. At the end of each month most states will provide you a transmittal form to send them a check for the sales tax you have charged or have you go online to pay and file. Some states also have a quarterly return which summarizes the activity for the three-month period. Businesses with low levels of sales tax may be able to file and pay annually.

Sales Tax Exemptions

Certain of your customers may not be subject to sales tax. Most states do not require you to charge sales tax to government entities or non-profit organizations. These are exempt organizations and they will normally give you an exemption certificate. Certain of your purchases may not be subject to sales tax. Most states allow you to issue an exempt purpose certificate to suppliers if you are going to resell the product or use it in a manufacturing process.

Use Tax

If you buy a computer in state, you will most likely pay sales tax on that item. However, if you bought the computer from out of state, you most likely will not be charged any sales tax. Your state would lose the sales tax revenue. Since they do not want to lose this sales tax, the state laws say that if you buy something out of state, which, if bought in state would have been subject to sales tax, and you paid no sales tax, then, you are using it in our state and you need to pay use tax equal to the sales tax. On the other side of the equation, if you sell product to customers out of state, you do not have to charge those customers your state's sales tax. The use tax is usually integrated into the sales tax returns.

Sales and use tax is the most confusing tax and can lead to tax delinquencies in state tax audits. Have a clear understanding of your state sales tax laws.

For more resources visit www.rjclark.com.

Payroll Taxation

The I-9 Form and W-4 form

When you hire a new employee you are required to have them complete a Department of Homeland Security I-9 form. Go to www.uscis.gov. Click on forms, then I-9. The employee marks if they are a citizen, a noncitizen national, an alien resident, or an alien authorized to work. The employer then needs to complete a section of I-9 showing the documents they reviewed verifying both identity and employment authorization. The employer does not file this form. It is retained in the employee file and must be presented if required by the government.

When you hire a new employee you are required to have them prepare a W-4 form. Go to www.irs.gov. Click on Forms and Pubs, then list of current forms, then type W-4. This form provides you the employee name, address, social security number, married or single status, and the number of personal exemptions the person claims for tax withholding. You may also be required to file a copy of this form or a new hire report with a state agency. You need to see

the employees Social Security Card to verify W-4 information. You can verify the card information online with the Social Security Administration. It is important to have an employee folder maintaining employee personal data, tax data, and work history. It is the employer responsibility to verify the employee status as an individual authorized to work in the United States. It is the employer responsibility to maintain the support documents and provide them if requested.

Gross to Net Pay

You must keep a time record on every employee in support of the gross pay computations. This is so that in the event of an employment audit you can justify that you meet both minimum pay and overtime laws. Employees are either salaried or hourly. Using time records you determine the employees gross pay for the period. The next step is to determine the employee federal withholding tax. You do this by using a government table. There are tables for weekly, biweekly, and monthly payrolls. Each of these shows tables for married and single taxpayers. You find the correct table (weekly/married), then the gross pay for this week on the schedule, and finally the column showing the number of deductions claimed. This will then tell you what the amount is to withhold for federal income tax. Next you multiply the gross pay by 6.2%. This gives you the FICA tax to withhold. This amount ends each year based on that years FICA maximum. Next you multiply the gross by 1.45%. This gives you the Medicare to withhold. Next come state income taxes. The state withholding in most instances follows tables similar to federal withholding. Most states have unemployment and disability deductions. These are usually a percentage of gross with annual limits. There may be other deductions for health insurance, union dues, etc. After these deductions are subtracted from gross pay, the net payroll

check is determined. Some items have special tax handling. For example, a 401K deduction is subject to FICA/Medicare but not federal withholding. You need to subtract the 401K deduction from the gross pay and then use the federal withholding tables. The IRS bible for payroll taxation is Publication 15 Circular E, Employers Tax Guide. Go to www.irs.gov. Click on Forms and Pubs, then list of current forms. Type in find Publ 15.

If you use payroll software, you will enter the employee W-4 information and the software will compute the gross to net checks, track payroll taxes due, make electronic deposits, and file forms electronically.

Payroll Tax Deposits

Most small businesses are required to make payroll tax deposits each month. You determine the tax due and make an electronic payment. You are required to make all federal tax payments electronically. For electronic filing registration and information go to www.eftps.gov. A similar procedure usually exists with your state tax deposits.

You need to determine the amount of the federal and state tax deposits. To do this you need a means either manually or computerized to add the gross to net of all the checks you wrote during the month. This is a monthly payroll journal. In addition, each individual check needs to be posted to each employee's individual cumulative earnings record. From these we can determine the total tax deductions for the month. The federal deposit is the sum of the federal withholding, FICA tax withheld then doubled, and Medicare tax withheld then doubled. The state procedures follow similar rules.

Quarterly Payroll Tax Returns

At the end of every calendar quarter you will need to report all your payroll activity for the period by completing a federal form 941. This form is due by the end of the month following the close of the calendar quarter. Go to www.irs.gov. Click on Forms and Pubs, then List of current forms, then type 941 in find. This form reflects all the information about your quarterly liability from your payroll journals and compares it to the amount of your monthly deposits. An additional amount due or an overpayment may result. The states also have similar quarterly tax returns. The 941 can be filed electronically or mailed. For most small businesses a quarterly federal unemployment tax deposit is required for the gross wages paid during the quarter. You make this deposit in the same manner as your regular monthly deposits except you mark it form 940. This tax is not withheld from employee pay.

Annual Payroll Tax Returns

At the end of the year you need to file your annual federal unemployment return. This is done on form 940. Go to www.irs.gov. Click on Forms and Pubs, then List of current forms, then type 940 in find. This form has you use your payroll records to determine the taxable unemployment wages and, then, compare it to what you have deposited to determine if you owe taxes or a refund is due. Your state will also have an unemployment form requiring preparation and filing

At the end of the year you need to let your employees know what their gross pay, federal withholding, FICA withholding, Medicare withholding, state

withholding, and state unemployment withholding were cumulative for the calendar year. The employee needs this information to prepare their personal income tax return. This is done on a W2 form and sent to the government with a W3 transmittal form. Go to www.irs.gov. Click on Forms and Pubs, then List of current forms, then type W2 in find, then W3. The states have similar procedures.

For more resources visit www.rjclark.com.

Employee vs. Subcontractor

The Problem

New business owners have a tendency to shy away from calling a person an employee until they know their business is successful. They may only need help periodically or only part time. They do not see that person as an employee or do not want to go through all the payroll requirements. So what they do is pay the person a gross check without any deductions or give them cash. They consider the person a subcontractor and give them a 1099 form at the end of the year or they do not even bother giving the person a 1099 form. This is a mistake that I have seen come back to haunt a business and in some situations result in the business termination. It is not unusual for someone who starts calling people subcontractors to just make it a standard business practice. If a person is working strictly for you, they should most likely be called an employee. Eventually, you let someone go or they are injured on the job. The person files for unemployment or disability. The state does not show them as covered. They send out an auditor. The auditor determines this person should have been an employee. They charge you taxes on this employee, plus all the others you are calling subcontractors,

they go retroactive for five years, and they add non-reporting and non-filing penalties plus interest. You don't have the money. The business you worked so hard for does not survive.

If you control a person's time or you retain ultimate responsibility for the work and how it is performed, you should consider your workers are employees. You cannot get in trouble calling them employees. You can get in all kinds of trouble treating employees as subcontractors. If a general contractor is building a house and hires a plumber to handle the plumbing, the plumber is a true subcontractor. The general contractor does not have a plumber's license. The plumber will normally be in business, work for other general contractors, have his own tools, and assume responsibility for the plumbing portion of the project. This plumber is a true subcontractor. If that plumber has individuals working with him as assistants, controls their time, retains ultimate responsibility for the work, and directs how it is performed, the workers should be considered employees and not subcontractors. You can find more detailed examples by going to www.irs.gov. Click on Forms and Pubs, then Lists of current forms, then type Publ 15-A in find.

Subcontractor Reporting

If you engage a subcontractor to perform services for you and they are not a corporation, you need to have them complete a W-9 form. You can find this form at www.irs.gov. Click on Forms and Pubs, then List of current forms, and then type W-9 in find. On the form the individual provides you their name, address, and identification number. This person is not covered by your insurance. You need to get a certificate of his insurance coverage for your file. In addition,

you should make sure that the individual provides you a timely copy of all renewals. You need to track all payments to each subcontractor. At the end of the year you need to complete a 1099 form and 1096 transmittal form. You can find these at www.irs.gov. Click on Forms and Pubs, then List of current forms, then type 1099 in find, then 1096 in find. The subcontractor uses this form to report income on his personal tax return.

For more resources visit www.rjclark.com.

Employee Benefit Programs

Everyone Needs Benefits

A misconception that some people starting in business have is that they can set up benefits for themselves and not for employees. They can but the expense is not deductible which negates the purpose. Another misconception is that it cost me too much to include employees. In today's society every individual needs health insurance. You as the owner need health insurance and your employees need health insurance. If you do not have a group health insurance plan, then your employee needs to get more money in his gross pay to allow him to pay for the insurance himself. If you do have a plan, you will be able to pay a lower gross because you cover the insurance. Without a plan, your employee gets a gross check, must pay taxes, and then must pay the insurance from the remaining net. The employer, because the gross is higher, pays higher payroll taxes. With a plan, the company takes a direct deduction for the cost, it is not taxed to the employee, and there are no payroll taxes. In addition, a company that has a full range of benefit programs retains employees, which reduces turn over and training time. Plus, if you pay the insurance, you know your employee is covered. If you leave

this to the employee, they may opt to use the health insurance money for a different purpose. If they are hospitalized and have no insurance, they may have collection agency and credit problems. You may have a troubled employee working for you. I feel strongly that benefit programs equal stronger employees.

The Benefit Package

You may not be able to afford any benefits initially. However, as your business progresses adding benefits should be a high priority. The first should be health insurance. Life insurance and disability policies are next. You can get group policies through your business associations or as a member of a local chamber of commerce.

For younger employees there is a real question concerning future social security benefits. A retirement program is a real incentive. There are wide ranges of programs. I recommend starting out with a SIMPLE plan. This plan does not require an annual accounting or annual tax return like a 401K. You simply put the money into an IRA in your employee's name and they are responsible from that point on. This plan encourages employees to save because you agree to match a percentage of the amount they save. If your employee puts nothing in, you put nothing in. IRS Publication 560 covers Retirement Plans for Small Business. Go to www.irs.gov. Click on Forms and Pubs, then Lists of current forms, then type Publ 560.

For more resources visit www.rjclark.com.

Pricing

The Pricing Problem

Two major problems that cause the business to fail are under capitalization and failing to pay taxes when they are due. The next biggest problem I run into is the business owner failing to recognize how much they need to charge for their time. Many people who start in business have been receiving paychecks. If their hourly rate was $15 per hour, they have a tendency to believe they should charge $25 per hour and everything will work out just fine. They seem to think that if they charge more they will not be able to sell their services to customers or compete in the market. They soon find that even if they are fully booked, there is not enough money to pay themselves, the taxes, the overhead, let alone make a profit to grow. To pay the bills and bring in extra money, the alternative is to work longer hours. This brings in the money but has another big negative. It takes away the balance of time that a business owner to be successful needs between business, self, and family time. If family problems develop, the business success is in jeopardy. Underpricing can lead to problems. If the competition is pricing low, let them go out of business. If your customers are shopping strictly price,

then find the right type of customer who is looking for a reliable source who is timely, does quality work, and is reasonably priced.

Three Times Payroll Cost Plus Materials

If you are paying a person $10 per hour, you should charge for their time at $30 per hour. If you want to make $20 per hour, you should charge $60 per hour for your time. If the two of you are working on a job, you need to average $45 per hour each.

If your employee is paid $10 per hour and works 40 hours a week, they would work 2100 hours and have an annual salary of $21,000. Will they be able to work on customer jobs the entire 2100 hours? Would you be able to? The answer is no. There are holidays, sick and vacation days, training days, lack of work time, and administrative days. So how many charged hours should you expect. I like to use 1/3 down time and 2/3 productive. That means we need to generate the $21,000 annual salary in 1400 hours. Or we need to charge $15 (1.5 times) just to pay the salary. I am going to take some liberties in my documentation. Just to meet the payroll taxes, employee insurance, and benefits, we need to be at 2 times salary. We have not paid for the truck, the accountant, the advertising, etc. This takes us to 2.5 times salary. We still have not produced a profit in order to make the business grow. This brings us to 3 times payroll plus materials cost as our base formula. If you go below 2.5 your business will probably not survive. If you are over 3.5, you are probably overpriced. This formula works for most service

businesses. In retail and other similar businesses, you need to generate sales, which produce this same payroll profit. Your gross sales less purchases will result in a gross profit, which should approximate 2 times your salaries. Every industry is different. Find a national business association servicing your industry. They will have financial models for you to follow.

The Salesman's Hat

If your pricing is right, then the next step, and most important step in your success, is to put on your salesman's hat and find customers. If you do not have customers, you do not have a business. Customers do not come to you. You go to customers. If you do not sell, you probably will not succeed. If you find a way to bring in customers, do it over and over and over. Do not bring in a few customers and then just turn your effort to delivery and stop marketing. Marketing keeps the door rotating. Develop a marketing plan and keep it going even when you are backlogged with work.

Breakeven Analysis

Once we have a pricing formula in place, we need to determine how much in the way of sales do I need to generate to pay me the salary I need to take home to pay my bills, cover the taxes on that salary, and pay my business expenses. We can start by saying you need to take home $40,000. This means that based on our previous 1/3 tax partner, you need to provide $20,000 for taxes. We next go to the expense accounts in the chart of accounts and estimate what those expenses will be. There are two type business expenses, fixed and variable. A fixed expense is going to be there even if you have no sales, for example rent. No matter what

your sales are your rent will remain the same. This type expense is a fixed expense. Using the chart of accounts come up with an estimated total for your fixed annual expenses. In my example I am going to use $15,000 in fixed expenses. Let's assume we sell shoes. When we buy a shoe for $25, we sell it for $50. We only have to buy more shoes when we make a sale. This expense only occurs when we make a sale. This is called a variable expense. It varies with sales. We do not express this type expense in fixed dollars but as a percentage of sales. In our example, our sales are $50 and our costs are $25. This means that our variable expense is 50%. The formula to determine breakeven is: X= $40,000 + $20,000 + $15,000 + .5X. When you solve for x you find your breakeven sales to be $150,000. You pay the $75,000 for the shoes (50%). This leaves you $75,000 for expenses. You pay your fixed expense, salary, and taxes totaling $75,000. Your profit is zero. You breakeven. It is imperative that you know the breakeven point. The person, who sets targets, makes targets. Set your target sales at least 10% above breakeven. In this example target sales would be $165,000 and after the cost of shoes would produce a bottom live profit of $7,500.

The Three Year Myth

I hear over and over again from new business owners that they expect it to take three years to make a business profitable. This may apply to large existing businesses coming into a new location, but it does not apply to you. Most new business owners do not have the capital to last one year, much less three. I believe a new business should set goals to reach breakeven levels not later than the third quarter of operations. In our example above we would want sales to be at $37,500

in the third quarter. This is tough task to achieve and another reason why the salesman's hat must go on early and stay on.

For more resources visit www.rjclark.com.

Business Plans

The 3 Year Plan

Why would I put a business plan so deep inside this book when most recommendations are to do a business plan before you even start. Over the years I would estimate that most business owner came into my office already having set up an LLC but never putting together a written formal business plan. They may have made a guess at breakeven but not much more. If you are going to seek a bank loan or other formal financing, you will need to prepare a formal business plan as part of the loan application process otherwise there is no requirement to do so.

I am not going to go into all the details of a formal business plans but address what you should have from a business budget approach. As I already stated, the business that sets targets, makes targets. You need to start with your breakeven figure and begin to set your financial goals. Our breakeven goal by the third quarter was $37,500. Let's assume first year sales $12,500 in quarter 1, $25,000 in quarter 2, our breakeven $37,500 in quarter 3, and $50,000 in quarter 4. This totals $125,000 in sales for year one. Continuing our previous example our

variable shoe cost would be $62,500, fixed expenses are $15,000, and our owner salary and taxes is $60,000. Our expenses for the first year are $137,500. We have a first year loss of $12,500. We need to invest at least $12,500 or explain how we will finance this short fall.

In year two we project quarterly sales to increase over each prior quarter by $5,000. We will add a new $30,000 employee commencing at the start of quarter three. We expect fixed expenses and owner salary and taxes to remain the same. Year two sales will be $250,000. Year two variable expenses will be $125,000. Employee salary will be $15,000, fixed expenses $15,000, and owner salary and taxes $60,000. Total expenses in year two are $215,000. Year two shows a profit of $35,000.

In year three we expect quarterly sales to continue at the same $5,000 per quarter increase, no additional employee needs, and no change in fixed expenses or owner salary and taxes. Sales in year three will total $330,000. Variable expenses will be $165,000, employee cost $30,000, fixed expenses, $15,000, and owner salary and taxes $60,000. Expenses in year three will total $270,000. Year three shows a profit of $60,000.

If you at least set sales goals you have a budget, you have a target, you have something to strive for. If you stopped at the target sales point you would probably be ahead of 75% of the new business owners who never took the time to set any target budgets. If you took it to the above level, you would probably put yourself in the top 10% of businesses.

There are many additional factors to a full business plan.

What will you contribute to the business when you start.?

What is the value of those assets or liabilities?

What business assets will you have to buy?

Will you pay cash for these or take out installment loans?

Will you need to buy up front inventory?

What will first year monthly sales be?

What is the total monthly cash loss before positive cash flow?

How will negative cash be covered?

Will you carry accounts receivable from customers?

Will you carry accounts payable from vendors?

The list can get very long. In addition, for every income and expense period, you also need to prepare a balance sheet and cash flow statement.

The next question is whether the target levels are realistic. If you say no, rethink what you are doing. If yes, adopt the budget and commit to the effort needed to reach the budget levels.

Budget Versus Actual

Each month you should compare your actual results to the target budget. You should review the reason for both positive and negative variances. Continue this same procedure for the next two months. At the end of the first quarter compare actual verses budget quarterly results and make some decisions. Revise the budget as needed. Roll the budget process forward. Take the next quarter and break it into months, revise the following three quarters, and revise the projected following two years. Run this same process every quarter and your budgeting process will become more and more efficient.

For more resources visit www.rjclark.com.

Executive Plans

Not The Business

This subject may not be appropriate to the current level of your business but at some point you will hopefully face the problem of profitability and not let yourself fall into this trap. As a business progresses and more money becomes available you must remember why you got into business in the first place. It was to accumulate personal wealth not to accumulate business wealth. This is accomplished by increasing your salary, giving you a bonus, increasing your employee benefits and putting money into your retirement savings. Do not forget that the business is not the objective. The objective is to accumulate personal wealth.

Target 45

Too often when the business owner suddenly has excess dollars to spend, they spend it unwisely. Did you really need that 5000 square foot home, that big new

expensive car, and a new boat? All these just increased your personal budget, which needs to be under just as good a control as your business budget. For the younger business owner, I like to set objectives and financial goals to reach before age 45. The first and foremost is to be sure the home budget is under control. The next objective is to accumulate 90 days in liquid emergency funds. Next we want to get the best tax deduction you can have and that is to buy a house. What if you should pass away or become disabled? You need life and disability insurance to safeguard your family. The next use of funds is to set aside education funds for children. And, we are not so very sure where social security will be when we retire so the next use of funds would be to retirement accounts. But it should be in this order.

Target 65

The next phase of life we call target 65. In this phase we maximize funds for retirement and turn our business into a saleable asset.

Target 90

Target 90 basically says we want to set our budgets so that we have adequate income through age 90 and give away excess assets to beneficiaries before we die so that those funds do not go to nursing homes, estate taxes, and inheritance taxes.

For more resources visit www.rjclark.com.

Financial Reporting

Buying a Condo

When you find a house you want to buy, you usually need to obtain a mortgage. If you want to buy a $100,000 condo, a bank will not give you the full amount in a mortgage. They want you to jeopardize your money before they will jeopardize theirs. They want you to put money down. They would like you to put 20% down and they will provide a mortgage for the remaining 80%. The condo costs $100,000, the mortgage is $80,000, and your down payment is $20,000. For every dollar you put down, the bank will lend you four dollars. This is the first step you have to meet in obtaining the loan, a 4 to 1 debt to equity ratio. They will still not lend you the money until they have an appraisal done to verify the condo is worth at least the $100,000. They need this assurance so that if you default they can force the sale of the condo and get back their money. They get paid back before you. This step assures adequate collateral. We have a person who wants to buy this $100,000 condo. They are going to put $50,000 down. The condo appraises at $150,000 but the bank will not make the loan. The person applying is on social security making only $500 per month. The money they have coming

in, less the bills they have to pay, does not leave enough to pay the mortgage. They do not meet the final step, ability to repay. You need to meet all three steps in the borrowing process whether this is a mortgage for a condo, a business startup loan, or an equipment loan.

The Financial Reports

The $100,000 condo is your asset. The $80,000 mortgage is your liability. The $20,000 down payment is your equity. The total assets, $100,000, equal the total liabilities and equity, $100,000. They are in balance. This is a balance sheet. In a business your assets would not be the condo but cash, accounts receivable, inventory, equipment, etc. Your liabilities would not be a mortgage payable but accounts payable, taxes payable, equipment loans, etc. Your equity would not be a down payment but your capital invested plus any profits you maintain in the business.

You record your business income and you subtract your business expenses. A positive difference is a profit, a negative difference a loss. This is called a profit and loss statement.

The Certified Public Accountant

Before you had your own business you gave your employer name and telephone number when you wanted to buy a car, a house, or a boat. They would call your employer to verify your income and ability to repay. Now that you are your own employer, they are not dumb enough to just take your word. They are looking for an independent person's signature on your records. They are looking for a

CPA signature. They will ask for tax returns, balance sheets, and profit and loss statements.

Preparation, Compilation, Review, and Audit

When a CPA is not engaged to prepare a compilation, review, or audit, the level of service provided is a Preparation level. The CPA does not issue a signed letter and designates that no assurance is provided. When the CPA signs a letter, which goes along with a financial report, designed for third party use, he is providing assurance. There are different levels of assurance in these letters. The lowest level simply says the CPA compiled the information based on information you supplied. Third parties usually accept this level. If you have a bank loan or need bonding, a review level letter gives third parties more assurance. If your bank or investors need the highest level, an audit level letter will be needed.

For more resources visit www.rjclark.com.

Business Borrowing

Credits Cards and Equity Lines

The historical way to start a business was to put together a business plan and then go to the bank and seek a loan. This at least made the new business owner think seriously about the business. And then came credit cards. We became comfortable using them personally and they just kept giving us higher and higher limits. And we could get multiple cards. So today instead of having to put together a business plan to obtain money, we simply get a credit card and start the business. As soon as you register the business, you will probably get another offer for a business credit card. If this isn't enough to keep the business going, the next step is to open an equity line on your personal residence. All this time, you never had to justify to anyone that you had a business plan and could successfully run a business. It is ok to use these funds to start but do not take this easy route without challenging yourself to take the business serious and develop a success plan.

Bank Loans

If it is going to take a large amount of money to start your business, go to the bank and ask them for assistance. They make their money by lending to business people just like you. Every business to grow will eventually need to borrow money. Establish ties to a bank and take advantage of bank financing. They make several type loans. For startup companies you may need to buy inventory and equipment, make rent deposits, and need working capital. This type of bank loan is normally paid back similar to your home mortgage with a regular monthly payment over a period of five to seven years. If the bank does not feel comfortable making the loan, they may be able to assist you in obtaining a Small Business Administration (SBA) guarantee for their loan. In business you may have temporary cash needs when a customer does not pay on time or for some similar reason. The banks have lines of credit. You obtain an authorization to be able to use up to an agreed amount simply by asking for it. You need to pay the bank interest every month but not principal until the cash flow problem clears. The bank usually wants this type loan paid down to zero at least once a year. They can also make commercial real estate loans, accounts receivable financing, and other creative ways to meet your needs. If you need money to start or grow your business, I strongly suggest your first stop be your own bank.

Equipment Leasing

Another source of startup funding is to look at your vehicle and equipment needs separate from your inventory and working capital needs. The equipment and vehicle dealers want to sell their products and will find a way to finance it for you.

Other Sources

If you have a unique patent or product, you may be able to find venture capital. However, venture capital is more interested in a company who is already successful but needs a large infusion of capital to take it to the next level. There are special state and federal funds for specific type businesses and type owners. Again, most start-ups will not meet the criteria.

For more resources visit www.rjclark.com.

Business Advisors

The Small Business Board of Directors

Do what you do best and let others do what they do best. Put on your salesman's hat and find customers then deliver and bill for your services. If someone fails to pay, do not spend your valuable time pursuing collection. Turn it over to your attorney and be happy if you collect anything. Bad debts happen. Do not let them depress you. Put on the salesman's hat, find a better customer, and you will grow your business. Your board of directors does not have to have quarterly meetings although as a small business you would put yourself high above the competition by having them. The referrals you would get from the board would more than offset the cost. If you do not have meetings at least set up lines of communications to the professionals who can most help you. Your small business board of directors should include a banker, an independent insurance agent, a lawyer, and a CPA. When your business grows, an investment advisor should be added.

The Banker

There are different type banks. As a business you want to deal with a commercial bank that works with small businesses. The next time you go to your local branch, meet with the branch manager. Just tell him you wanted to find out what services their bank has available that you might need and before you know it they will ask you about your business. The link will be made.

The Independent Insurance Agent

You need at least a liability policy if you are in business. Seek out a local insurance agent. He will be able to determine what type insurance is appropriate for your business. At the same time, you now have another potential local referral source.

The Lawyer

There are different type lawyers. You do not need a divorce lawyer. You hopefully do not need a criminal lawyer. You do need a local lawyer who handles the needs of small businesses and small business owners.

The Certified Public Accountant

There are different types of CPAs. You do not need a CPA who specializes in preparing personal income tax returns. You do not need a CPA who specializes in audits of governmental entities and non-profits. You need a CPA who

specializes in services for small businesses and their owners and will be working with you all year long.

For more resources visit www.rjclark.com.

And Much More

Today many sources for new business owners are via internet websites. I have reviewed many of these sites and set up links to them on my website.

For more resources visit www.rjclark.com.