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Accounting:

Doing it well is a necessary evil!

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When business people and entrepreneurs get into business they want to build a better mouse trap, deliver better service, serve better food, follow a passion. Keeping the books accurate and up to date is last on the list of priorities given all the other demands and interests. In fact they might not have the time or skills to do it themselves.

In addition to following their dreams, business people and entrepreneurs want to build something of value to hopefully be able to cash it in down the road for all the blood, sweat, tears, and risk they put into it. Business owners please heed this advice: good timely, accurate accounting is critical to that achievement! I repeat: good timely, accurate accounting is critical to that achievement!

The good news is with today's software, community education and/or plenty of available bookkeepers this is a doable task. It can be done in-house or outsourced at reasonable rates. These reports are not only useful for down the road when you want to sell, but in the interim it's critical for bank financing and as a useful management tool.

I'm going to outline some of the bookkeeping approaches I've seen. Each progressively gets better, but my advice is NOT to move one step up at a time as I outline below, but to *start* as close to the ideal as possible.

Raw small business entrepreneur - These guys are raw energy. They just jump in and have at it. They don't have any bookkeeping knowledge, they just do what needs to be done

and at the end of the year they may or not file a return. If not, they say they will do it next year and are willing to assume any penalty and interest charges. Their sense of well-being is whether there is enough money in the check book to make payroll. In effect the checking account's bank balance is the accounting.

Small entrepreneur that survived his first or second year - Cash is always tight so they don't want to incorporate or incur any other 'unnecessary expenses'. They finally take the box of receipts and bank statements to a tax preparer and say 'can you get my taxes filed by the deadline?' They file a Schedule C return



as part of their personal return. Basically they think what is on the bottom line is what they made. They then compare year to year what, if anything, is in the bank account and the bottom line and measure their success accordingly.

Business is surviving and perhaps growing - At this point they may decide that incorporating will perhaps protect them from some liabilities (now that they may have something to lose) and may save them some money in taxes. They file an LLC or S-Corp. Business Return. 'What they earned' is now shown in two places - one as 'Officer Compensation' - what they earned and also 'The Bottom

Line' - what the *company* earned. An unexpected benefit is that they start to differentiate between their individual contribution as reflected in Owner Compensation and the contribution the business makes as reflected in the bottom line (A reality for some is that *they* are the business. There is no contribution from the business to the bottom line). See previous article: *A Trade or a Business*.

Growing business - The business is past the start up stage and is growing. The business owner has discovered that looking to profitability more than once a year is beneficial. In fact, he is now looking at the Profit & Loss monthly. Better yet, he's comparing it against a well-thought budget and measuring performance against it, making timely adjustments throughout the year. Ah, the beauty of small business is being able to be quick and nimble and capable to react to changing circumstances! The management now has a tool to assist in this competitive advantage.

Stable profitable maturing business - Business owners are like everyone else. They don't like to pay too much in taxes. They have learned on their own, or with assistance from advisors, that there are ways to get more benefits (perks) out of the business and thus reduce their tax burden. So now the business owner is running the business and 'working the Profit and Loss': insurances, balancing tax brackets, rapid depreciation or expensing of equipment, auto expense, advancing or deferring income or expenses into different years, setting up profit sharing plans, etc. All are legal and allowed by the IRS. The net income is now reduced

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by these expenses. The business owner now has to look at three areas of benefits: the Owner Compensation, the bottom line, and the perks, to measure results of the business (Also, some business owners also deduct some expenses or don't show all income that are either in the grey area or downright not allowable. See our *Skimming* article on our web site).

Mature Business - The Profit and Loss compared against Budget is now just one of many financial reports the company generates. The Balance Sheet that covers assets and liabilities is now a critical management tool, as are; cash flow reports, receivable reports, reports by division, reports by product or service. This allows the Management information to have a handle on things and fine tune the operation, to recognize change and anomalies so they can make adjustments quickly before things get out of hand, or capitalize on things before the competition does. The Board of Directors or Management may make compensation and hiring/firing decisions based in part from this information or perhaps decide which divisions or product lines to invest further in or drop. By this time the owner has been well educated in how to read these reports or relies heavily on key employees or consultants in the Finance part of the business.

Back to the beginning: Accounting is more than bean counting of past performance. It's more than a requirement so you can file with the IRS. It's the foundation of taking control of the business, making plans for the future, measuring and adjusting those plans, for taking control of the business. However, you still need to build a better mouse trap, deliver better service, serve better food, follow a passion. By doing that and adding good financial controls hopefully we will be talking about the **reward** for doing all that when it's time to SELL! And, you will have a business worth buying!

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