

University of Mississippi

eGrove

Guides, Handbooks and Manuals

American Institute of Certified Public
Accountants (AICPA) Historical Collection

1984

Business information guide

American Institute of Certified Public Accountants. Minority Business Development Committee

Follow this and additional works at: https://egrove.olemiss.edu/aicpa_guides



Part of the [Accounting Commons](#), and the [Taxation Commons](#)

Recommended Citation

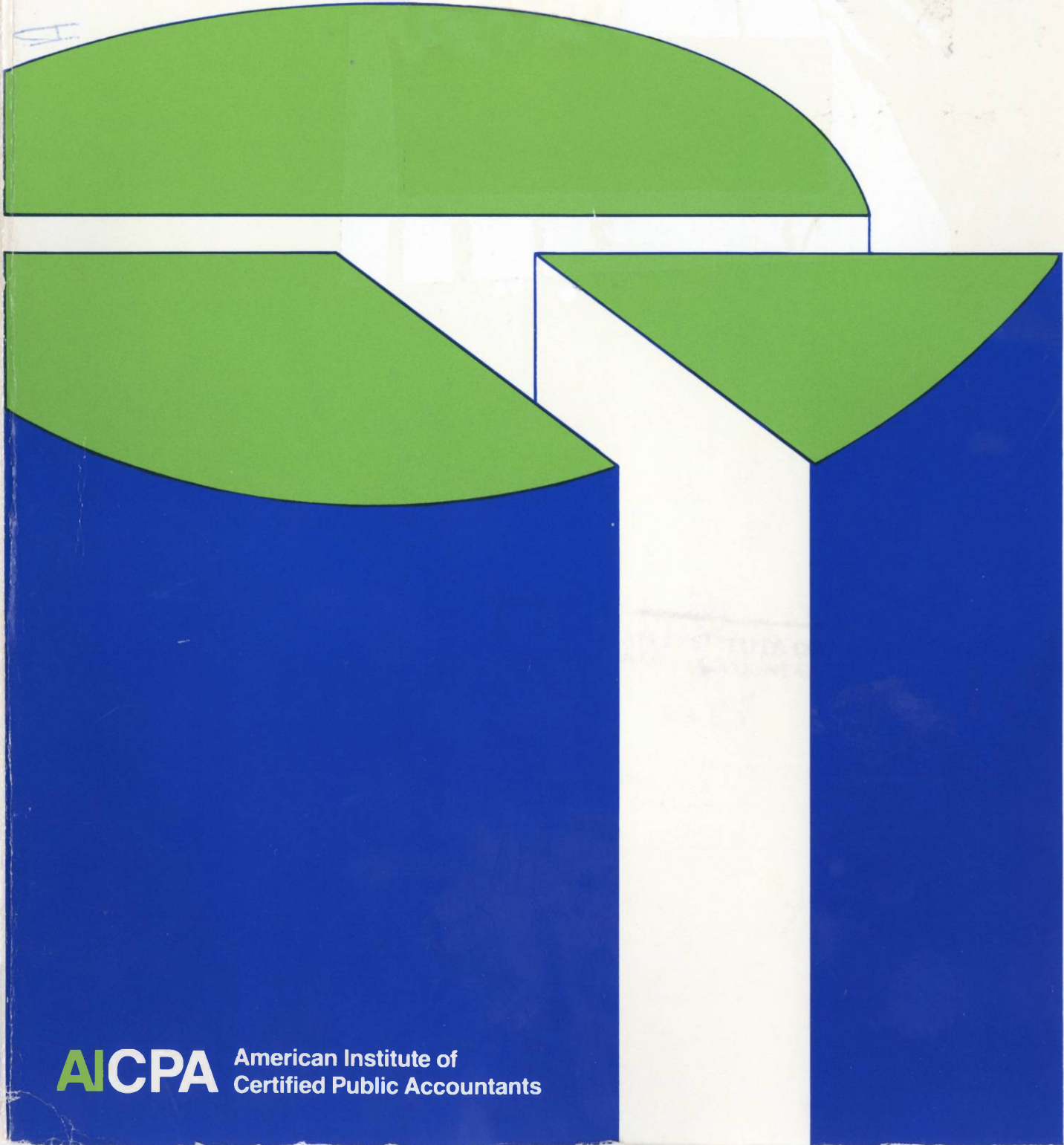
American Institute of Certified Public Accountants. Minority Business Development Committee, "Business information guide" (1984). *Guides, Handbooks and Manuals*. 1210.

https://egrove.olemiss.edu/aicpa_guides/1210

This Book is brought to you for free and open access by the American Institute of Certified Public Accountants (AICPA) Historical Collection at eGrove. It has been accepted for inclusion in Guides, Handbooks and Manuals by an authorized administrator of eGrove. For more information, please contact egrove@olemiss.edu.

Business Information Guide

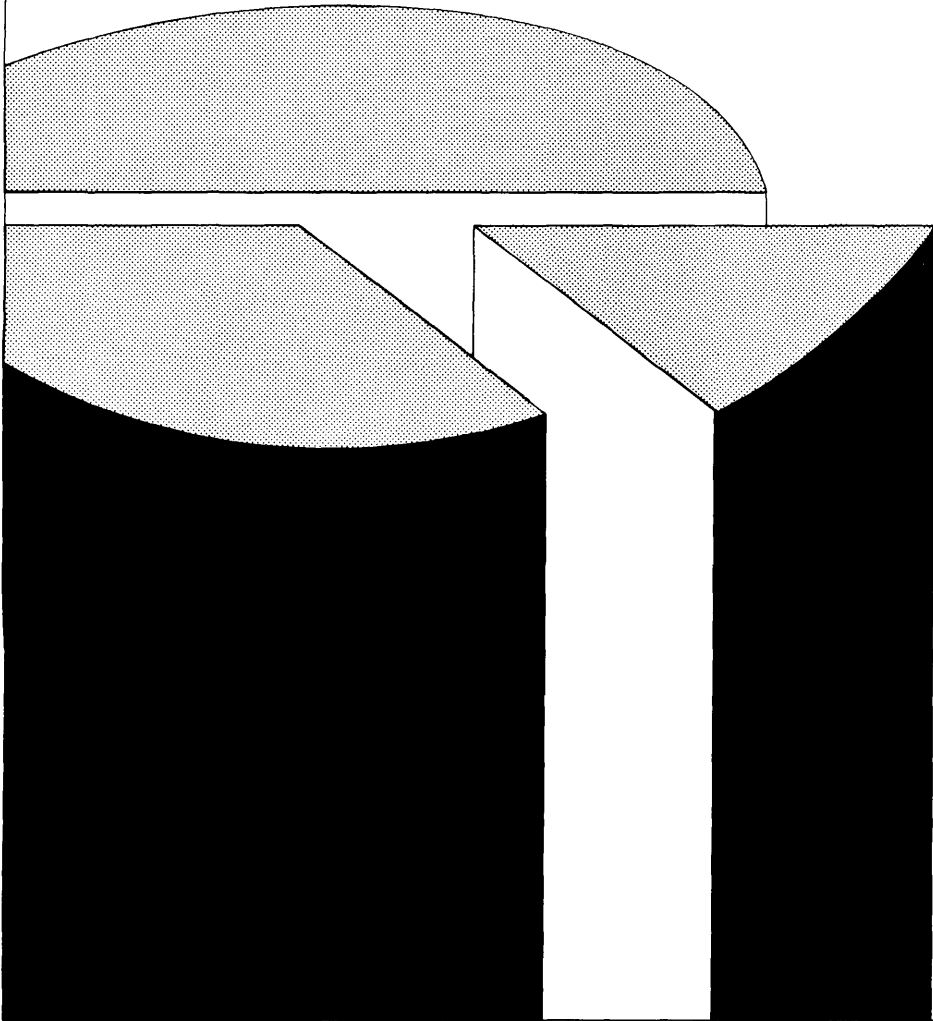
BUSINESS INFORMATION GUIDE



AICPA

AICPA American Institute of
Certified Public Accountants

Business Information Guide



AICPA American Institute of
Certified Public Accountants

Copyright 1972, Businessman's Information Guide
© 1980, Businessman's Information Guide (Second Edition)

© 1984 by the American Institute of Certified Public Accountants, Inc.
1211 Avenue of the Americas, New York, N.Y. 10036-8775

1 2 3 4 5 6 7 8 9 0 IPM 8 9 8 7 6 5 4

Foreword

The *Business Information Guide* reflects the changed environment in which small businesses now operate. In recognition of the increasing number of small business owners who are women, the committee changed the original title, *Businessman's Information Guide*, to *Business Information Guide* in order to remove any trace of gender bias. The AICPA Minority Business Development Committee, which is responsible for updating BIG, believed several modifications were necessary to maintain the Guide's usefulness. Chief among them is a new chapter that helps a business person select a computer – if one is needed. Updated tax information was also added. (It is important to note that a Spanish edition of BIG is also available from the AICPA.)

Appreciation is expressed to members of the 1983-84 AICPA Minority Business Development Committee who developed this edition: Lawrence Belcher, Jr., Chairperson; Charles T. Barrett, Jr.; Tyrone Dickerson; James Hill, Jr.; Bruce C. Holbrook; Jack B. Kase; Howard N. Miller; Norbert W. Muench; Virginia B. Robinson; Michael M. Vekich; and Stuart J. Zimmerman. Special thanks are given to those committee members who participated in the subcommittee overseeing the updating process: Robert J. Jimenez, subcommittee Chairperson; Bobby T. Martin; and J. Gary Robb. Appreciation is also expressed to AICPA staff members Mary Feinstein and Richard Jupa who coordinated and edited this edition.

NANCY MYERS, *Director*
Industry and Practice
Management Division
November 1984

Contents

FOREWORD

PREFACE – *Businessman's Information Guide*

HOW TO USE BIG

SECTION 1 Starting a Business

SECTION 2 Business Records

SECTION 3 Chart of Accounts

SECTION 4 Business Statements

SECTION 5 Business Taxes

SECTION 6 Using Outside Help

SECTION 7 Computers for Small Businesses

SECTION 8 Business Words

Preface

Businessman's Information Guide

Abraham S. Venable, former Director of the Office of Minority Business Enterprise (now Minority Business Development Agency), once wrote in the magazine *Black Enterprise*, that he had reviewed 500 or more articles and books on minority business. All of them criticized one thing or another, but not more than two or three dealt with solving problems. In recent years, he had reviewed hundreds of proposals to the federal government for funding projects for business assistance; 95 percent of the material explained the problems and only 5 percent dealt with how to solve them. One of the greatest difficulties, he felt, was that these business people did not understand systems and procedures. Systems are a series of steps to get to a desired result; procedures are the details of the steps in the system. One of the most important things needed was help in supplying the technical assistance to build a business that could prosper and grow.

Those who worked on this project believe that small business, in general, suffers from a lack of technical assistance. This *Businessman's Information Guide*, which will be called BIG, is a joint effort of individuals who have had broad experience in advising and assisting various areas of business. The object in developing BIG was to provide a general set of guidelines to those who plan to or who already own small businesses. Users of BIG must bear in mind that these are general guidelines and cannot be specific or exact for all businesses. They suggest the type of things that should be done. When experience or training is not enough to perform certain tasks or to make a necessary choice, professional or experienced assistance should be sought.

This project was conceived by the Committee on Business Opportunities (now Business Counseling and Education Committee) of the Illinois Society of Certified Public Accountants. While many of the persons contributing to BIG are members of that society and others belong to similar professional groups, the contents of BIG do not necessarily reflect the views of any of such groups or their members, nor has any portion of BIG been acted upon by the membership or the governing body of any professional group. The business instruction necessary to supplement this guide should be obtained from the appropriate professions.

Deep appreciation is expressed to the individuals and representatives of organizations to whom the manuscript was exposed for comments and suggestions. Special acknowledgment is due Robert Boyer, Chairperson, Committee on Economic Opportunity (now Small Business Development Committee), AICPA; Sidney F. Jarrow, who conceived the project; and Ernest R. Wish, Chairperson, Committee on Business Opportunities (now Business Counseling and Education Committee), Illinois Society of CPAs; and also to the following persons who contributed materially to its content: Vernon H. Abbott, Marie Bareille, John P. Breitbach, Ansel H. Edidin, Mary J. Hartigan, Jerry Hickman, Steven D. Lustig, Lawrence M. McGaughey, Stephen L. Seftenberg, Christopher W. Seidel, Jack E. Swanson, William E. Taylor, and Karen Will.

SAMUEL A. SAKOL, *Editor*
Glencoe, Illinois
October, 1972

How to Use BIG

The developers of BIG have designed the guide particularly to assist persons who are in the process of setting up a small business. BIG provides help in the planning stage, in setting up adequate records and control procedures, and as a reference source for steps to be taken when the business is operating. It should be helpful too for businesses already operating, as a comparison of what *is* being done with what *might* be done to add to successful operation of the business.

BIG is intended to be used for different kinds of business and by people who may have quite a lot, a little, or no business experience or training. As a result, parts of it may be too simple or not needed by some, and parts may be too difficult or not needed by others. Plan to use what fits your needs; get outside advice on what you may not understand.

BIG is organized according to the following working sections:

Section 1 — Starting a Business. What to find out, figure out, think about and decide before going into a small business.

Section 2 — Business Records. What kinds of forms and records are necessary to operate a small business.

Section 3 — Chart of Accounts. An explanation of how it is used and a suggested chart of accounts for a small business.

Section 4 — Business Statements. What types of statements can be used to show how the business has done, and what condition it is in presently.

Section 5 — Business Taxes. What you should know about some of the many different kinds of taxes that a small business may have to pay.

Section 6 — Using Outside Help. Why, when, and what sources of outside help may be needed.

Section 7 — Computers for Small Businesses. How to decide if your business needs a small computer and advice on the selection process.

Section 8 — Business Words. For those who may not be familiar with them, a list of words used in BIG, and in business, with a simple definition of their business meanings.

Upon getting a copy of BIG, you should look through the entire contents quickly to get some idea of the material. You should not be discouraged if you do not understand everything at this first reading. As you progress through each stage, particular sections should be carefully studied. Use BIG as a working tool so that, in time, it will become the specific guide for your business.

Section 1

Starting a Business

Contents

	<i>Page</i>
About Small Businesses.....	3
What Is a Small Business?	3
What Is Required to Start a Successful Small Business?	3
Small Business Planning Checklist	4
Proposed Products or Services	6
Definition	6
Qualifications	6
Restrictions	6
Economics	6
Facility Requirements	7
Use of Facility	8
Description	8
Estimated Cost of Facilities	8
Estimating Your Costs	8
General Information on Costs	8
Volume	9
Other Costs	10
Estimating Your Fixed Cost	10
Estimating Your Direct Costs	10
Estimating Your Other Costs	11
Summarizing Your Cost Estimates	13
Estimating Your Selling Prices	15
Sales Forecasts	15
Preparing Your Projected Cash Flow	17
Source of Cash Flow Data	17
Preparing the Cash Flow Projection	17
Determination of Capital Required	20
Providing Financing	20
Sources of Financing	20
How to Contact Sources of Financing	21
Your Business Organization	22

Starting a Business

About Small Businesses

What Is a Small Business?

A small business is usually considered one with few employees and assets, rather low sales volume, and not much capital. The owner is usually directly involved in the management as well as the operations of the business and may not have had much training or experience in accounting, taxes, finance, or business practices and procedures.

What Is Required to Start a Successful Small Business?

It is important to realize that to start a new business of any type is to be exposed to a risk of business failure; to start a small business is to increase the exposure; to start a small business without enough financial support further increases the risk; and to start such a business without enough advance planning and without seeking the information necessary to run the business is to increase the risk of failure almost to the point of certainty.

According to *The 1983 Dun & Bradstreet Business Failure Record*, there were 31,334 business failures in the United States, of which approximately 50 percent were small businesses. The same source stated: "Underlying causes of business failures include incompetence, lack of well-rounded business knowledge, and lack of experience in a particular industry."

The type of small business most likely to succeed is one that is—

- Based on a product or service that can be
- Obtained in necessary volume at a low enough cost, so that after adding a profit, it can be
- Sold at a competitive price to
- Buyers who will pay for it, and in total, who will buy enough so that a volume sufficient to make a continual profit will be reached.

What follows is intended to aid you in determining if your idea is a sound one on which to build a small business and, if you decide that it is, to point out other considerations you must face.

Small Business Planning Checklist

Before actually starting a small business, you should prepare a checklist of items to be covered in planning. While you are trying to decide, the list may be increased as new items come up. Such a list should—

- Provide direction to the planning effort to keep it orderly and logical.
- Serve as a record of items considered, rejected, and approved, in order to avoid redoing something already done.
- Provide target dates for action.
- Serve as a record of the extent of planning.

Specific items on the checklist (see sample, page 5) may include, but are not limited, to the following:

- Definition of the proposed product or service
- Facilities required
- Cost estimates
- Sales forecast
- Cash flow
- Financing
- Organization

Most of the above items are so closely related that one depends on another.

What follows in this section deals with starting a new business. But most of it, if not all, also applies if an existing business is to be bought from someone. The only real difference is that it may be easier to get some of the information from the present owner, if it is available and can be relied on. This section also presupposes that the business will make and sell a product. Though some of it would not be necessary for a business that buys and sells a product or sells a service, the general guide to getting information for decision-making would still apply.

**Small Business Planning Checklist
(To Be Used in Conjunction With Business Information Guide)**

Things to Do	Suggestions in BIG	Suggested Form	Record of Action		
			Target Date	Date Completed	Notes of Reviews, Discussions, Changes, Etc.
Define Products	Sec. 1 Page 6				
Determine Facilities Needed	Sec. 1 Page 7	Facilities Requirement Worksheet			
Determine Product Costs	Sec. 1 Page 8	Summary of Estimated Costs			
Project Sales	Sec. 1 Page 15	Sales Forecast			
Project Cash Flow	Sec. 1 Page 17	Projected Cash Flow			
Arrange Financing	Sec. 1 Page 20				
Set Up Organization	Sec. 1 Page 22				
Other Items					

Proposed Products or Services

Definition

The first step in starting a new business must be to have a clear idea of the products or services upon which your business will be built. You must be able to describe, first to yourself and later to others, what you plan to do.

Write, in everyday, nontechnical words, a simple definition of the goods or services that will be the source of income to your business. Be as specific as you can. Include in your definition a brief description of your potential customers and area and method of sales.

Your first attempt to prepare an adequate definition will be difficult and probably incomplete. Keep working on it until you are satisfied. Then get someone to read it to determine if it is clear to others.

As your planning progresses, your first ideas of the products or services you will offer may change; if so, rewrite your definition. Remember, this will be the basis of all the other planning steps, and later, the source of your income. Be sure you know your products or services and can clearly describe them to others.

Qualifications

Having developed a sound written description of the products or services to be sold by your business, you must next make a careful analysis of your ability to handle the product or service. Is it something with which you have had experience or training, or do you expect to “learn as you go”?

Make as complete a list as you can of all the skills required to get your product or service to the customer. Opposite each item on the list indicate your abilities for those you plan to handle yourself, or the source of help if you expect others to handle the item. You may have open tasks. Put these on your checklist (Sec. 1, page 5).

Does your idea for starting a business still look good to you?

Restrictions

When you are satisfied that all necessary tasks involved in your proposed business can be handled, you must make sure that there are no government or business restrictions that would stop you from being in that particular business. Are there local, state, or federal laws prohibiting or regulating the business? Are there any qualifying licenses required? Are there any patents, copyrights, or business franchise restrictions?

If you are not certain about answers to these questions, put them on your checklist.

Economics

Without being concerned at this point in your planning about the profit possibility of your business idea, examine your source of sales. Is yours a seasonal or a year-round item? Is it a one-time or a frequently needed purchase? Is it a new item for which a demand must be created, or is the demand already there? How is the demand now being met—by the same item or by another item? How does your item compare with the existing one? How will you sell your item—through existing outlets, by mail, or by your own sales group or outlet? Does your item require after-sale service? What type of competition will you face? Who will be your suppliers? What is the normal method of payment for your type of item?

In asking yourself these questions, you are also asking if your idea still looks good to you. Does it?

Use of Facility

The use to which the facility will be put will determine the order of the listing. If yours is a service type of business, there will be few Use classifications. If there is a product involved, there may be several. Examples of Use classifications include the following:

- Storage (for raw material, purchased parts, items ready to sell, supplies)
- Manufacture (may be one or more classes, depending on the nature of your product)
- Shipping, Receiving, Delivery
- Sales
- Office

When one facility is used for more than one purpose, it should be listed under Multiple Use. The cost for such a facility will be divided among the various purposes it serves and the item listed under each use. For example, a building may be used for manufacture, sales, and office purposes. The costs of using the building would be divided according to the purposes for which it is used.

Description

Each facility required for a given use should be listed. For example, under such a caption as Sales Use you may list "Store." Then under Store list the description, size, and general location of the type of store best suited to your purpose. Next, list the same data for your second choice of a store, and finally, the least desirable type of store and location that could be used for your business.

Then do the same thing for Store Fixtures and continue until all your required facilities are listed. In some cases you may have no second or third choices.

Estimated Cost of Facilities

Prepare an estimated cost of the most desirable, next most desirable, and least desirable facilities that you have listed.

When this task has been completed, you will have everything required to determine the capital needed for facilities, the basis for fixed costs, and a control sheet to keep track of your commitments for facilities.

The actual facilities you get will be the result of decisions you must make by working out a balance between your available capital and the effectiveness of differently priced facilities. Be sure you consider both buying and renting as you make these decisions.

If you need help in this task, see Section 6, "Using Outside Help."

Estimating Your Costs

General Information on Costs

The following is intended to help you understand and prepare cost estimates for a small business selling products or services that are similar in the way they are prepared for the market. More involved procedures would be needed for widely different items produced in a single business. Do not hesitate to get outside help in preparing and reviewing your estimates.

The cost of operating your proposed business is made up of various parts, depending on the type of business. In general, these will include the following costs.

- *Fixed costs.* These are the costs that are about the same from the day you start in business. Rent, light, power, and depreciation are types of fixed costs. Your salary may also be included here. Fixed costs are the same regardless of the amount of your sales or production.
- *Direct costs.* These are costs that go up or down with increases or decreases in your sales and production. The product you buy to resell to your customer or the material and labor of making the product yourself are direct costs. Direct cost may be *material cost* if it originates with a purchase you make, or it may be *labor cost* if it is your payroll. All direct costs can be related to a particular product or service.
- *Indirect costs.* These costs may vary from period to period but not necessarily in the same proportion as your sales or production. They are for those goods and services necessary for your business but not related to particular items that you sell.

Volume

From that oversimplified explanation of cost factors you can determine that the cost of your product or service, at the point in time it is ready to be sold, includes the direct cost of the material and labor going into it plus some portion of the fixed and indirect costs. The amount of fixed and indirect cost that each product or service must carry depends on the number or volume of items produced and sold.

At the end of any given period the volume is known and the actual cost can be determined. However, you cannot wait until the end of a period to determine your costs and the related selling prices. Therefore, it is necessary to estimate the volume before you can estimate the cost.

Your estimate of volume must represent a realistic balance between your ability to produce goods or services and your ability to sell them. In most cases the amount of fixed and indirect costs to be added to the direct cost of an item can be best stated as a percentage of the direct cost.

For example, if your estimated monthly volume is 500 units at an average direct cost of \$20 each, and estimated monthly fixed costs are \$1,000 with estimated indirect costs of \$500, the overhead rate and unit costs would be as shown below.

	Fixed cost	\$ 1,000
	Indirect cost	<u>500</u>
Your overhead =	Total	\$ 1,500
Direct cost = 500 X \$20		<u>\$10,000</u>
Overhead + Direct =		<u><u>\$11,500</u></u>
Your overhead rate is:		
	$\frac{1,500}{10,000} = 15\%$	
Unit costs = \$20 + (15% X \$20) = \$23		
500 units X \$23 =		<u><u>\$11,500</u></u>

Therefore, your selling price must be set based on a \$23 cost.

Other Costs

In addition to the costs described above, you will probably have selling costs and general and administrative costs. The selling costs will include sales salaries, commissions, advertising, and similar items related to your sales efforts.

General and administrative costs include office salaries and supplies, interest, taxes, and similar items. Both sales and general and administrative costs are added to each item as a percentage in the same manner as described for fixed and indirect costs.

Estimating Your Fixed Cost

Because of the relationship of your fixed cost to your cash flow and financing (discussed later in this section), it will be necessary for you to make some assumptions that may later have to be changed. However, it is better to estimate your cost on the high side than estimate too low, so you should use the Most Desirable cost figures shown on your facility work sheet to estimate fixed cost.

In setting up your facility work sheet, you have grouped the various items by the use or function they serve. By so doing, you have divided your facilities into production, sales, and office use.

Write the monthly cost after each item on the work sheet. For items that are rented or for which you will receive monthly bills, you already know the monthly cost. For items you will buy, the monthly cost is determined by dividing the amount you expect to pay for an item by the number of months you expect to use it.

The total of the monthly costs for each item within a use group will give you the estimate of the fixed costs for that group.

Estimating Your Direct Costs

Remember that direct costs are made up of the material and labor costs that go into the item you will sell, whether you deal in products or in services.

To estimate your direct costs, you must first make a list of all the materials going into the item (this list is called a *bill of materials*) and a list of each task of labor required to complete the item (called an *operations sheet*). Your ability to prepare the necessary bills of material and operations sheets is a good test of your qualifications for your proposed business.

Estimate the cost of the materials and of the labor operations. Be sure to include the necessary scrap or waste in the materials and any freight or handling costs related to the materials. Labor costs should be estimated on the basis of the time required for the operations multiplied by the rate you will pay for labor. The time factor should include a normal amount of lost time. The labor rate should include the taxes and any fringe benefits for which you expect to pay.

Estimating Your Other Costs

The indirect costs, sales costs, and general and administrative costs may each contain fixed costs (from your facility work sheet), material costs (mainly supplies), labor costs, and certain other costs such as interest expense.

Prepare a sheet for each type (indirect, sales, general and administrative) in the same manner you did for direct cost.

Summary of Cost Estimates												
Direct Costs												
Per Unit Costs			Full Costs				Overhead Costs			Total Costs		
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
Material	Labor	Total per- Unit Direct Costs	Volume	Total Material Costs (1x4)	Total Labor Costs (2x4)	Total Direct Costs (3x4)	Overhead Rate (Schedule A)	Total Overhead Costs (7x8)	Total Costs (7 + 9)	Percentage Markup	Markup In Dollars (10x11)	Sales Price (10 + 12)
Item A	5	10	100	500	1000	1500	.0220	33	1533	33%	\$505.89	\$2038.89
Item B	7	18	50	350	550	900	.0220	19	919	33%	\$303.27	\$1222.27
Item C	4	13	25	100	225	325	.0220	8	333	33%	\$109.89	\$ 442.89
Total	16	46	175	950	1775	2725	.0220	60	2785	33%		

Summarizing Your Cost Estimates

The "Summary of Cost Estimates" work sheet can be used in summarizing your cost estimates and in setting your selling price. It is not as difficult as it may appear; you have already finished the hard part of your estimating task.

From the estimate sheets you have prepared, copy the unit estimates of direct material cost and labor cost for items (products) in columns 1 and 2. Add the material and labor costs to get the total for each item horizontally (column 3). Also, add the material and labor costs to get the total costs for all items, and the total cost for all items (adding vertically). The total material plus the total labor must equal the overall unit total in column 3.

Next, fill in column 4—Volume—for each item you expect to sell. Complete the Full Costs section of the work sheet—columns 5, 6, and 7—by multiplying volume by direct-unit material cost, direct-unit labor cost, and total per-unit direct costs.

Before you can complete the Summary Work sheet you need to complete Schedule A—Overhead Costs (see page 14). Again, from your estimates, copy the overhead for indirect, sales and office (general and administrative) costs. It will be more informative if you indicate the cost sources (Material, Labor, Fixed, Other). Add these costs both horizontally and vertically to get total costs. This step will prove that you made no arithmetical errors.

Now, you must figure the overhead rate. Divide your total direct cost (column 7) into the total indirect cost (Schedule A, column 1). Do the same for your total sales cost, total general and administrative cost and total overhead cost. Please note that the total overhead cost (Schedule A, column 4) is the only one you will use in determining the full cost of your items. The other rates will be used later as a measure of your ability to control costs. Copy the overhead rate into column 8 of the Summary Work sheet.

Determine your total overhead cost (column 9) by multiplying columns 7 by 8. Next, determine total costs (column 10) by adding columns 7 and 9. This will help you determine your selling price.

Determine your percentage markup (column 11) for each item. Use this figure to determine your markup in dollars (column 12) and sales price (column 13).

Schedule A
Overhead Costs

	(1) <u>Indirect</u>	(2) <u>Selling</u>	(3) <u>General and Administrative</u>	(4) <u>Total</u>
Material Cost	2	4	3	9
Labor Cost	5	7	6	18
Fixed Cost	10	8	9	27
Other Cost	3	2	1	6
Total Cost	20	21	19	60
Overhead	20/2725 =	21/2725 =	19/2725 =	60/2725 =
Rate	.0073	.0077	.0069	.0220

Estimating Your Selling Prices

When you have completed your cost estimate summary, you know the figures upon which you must set your selling prices. How do these compare with the price of the items with which you will be competing? If your full cost is equal to or higher than the competitive item, you have either estimated some factor too high, or there is a serious possibility that you should not go into your proposed business.

Look at the amount of overhead cost in each item. Can you realistically expect to cut this—either by reducing your overhead estimate, or by spreading it over an increase in your estimated volume? Could you reduce your estimate of direct cost by changing material, or by having someone else do a portion of your labor? Now is the time to face up to such problems.

If your full cost is lower than competing items, how do you set a selling price? You must get enough for your item to pay your taxes, to repay any loans you may have incurred to get started, to get a fair return on the investment made in your business, to build up adequate reserves for future growth, and to carry you over unforeseen adverse business events.

On the other hand, you must not set a price so high that it will prohibit or greatly reduce sales or will be an invitation for competition to enter your field.

This is another test of your qualifications to enter your proposed business. You should know enough about your items, your competition, and your markets to set your selling prices. When you get your business started, you will be making many business decisions as difficult as this.

Do not overlook the possibility of having someone from the outside advise you about your selling prices. (See Section 6, "Using Outside Help.")

Sales Forecasts

You have already estimated your volume and set your selling prices. Your sales forecast must be made on the basis of these two factors. In addition, you must consider any seasonal variance that is to be expected in your business.

One other important factor is the rate at which you will go from zero sales (before you start) to what you expect your normal volume to be.

The sales forecast will be used to estimate your cash needs. Do not be too optimistic in your forecast for the early months of your business. If you fall much below your estimated sales volume, you will probably find yourself short of the cash needed to keep your business operating. Remember that you will have to pay for labor, material, rent, and so forth every month. Many businesses fail within their first year because of cash shortages, even though they are operating at a profit. Cash problems may also occur if the business expands more quickly than was expected.

To prepare your sales forecast, use a work sheet set up as shown.

Write the number of units of each item you expect to sell in each month. Then write the number of units you expect to have returned each month. Multiply the units by the unit selling price. (If your business is based on many different items of a similar nature, you may have to group like items and use an average price.) Then add the units and amounts for each item listed in the first month to the same item in the second month to get your year-to-date forecast.

Please note that the forecast sheet provides space to indicate the actual sales made. You should check to see how close your sales forecast is to actual sales from time to time. This will enable you to adjust purchases of material or your payroll, as appropriate, at an early date. Also, this will help you in making the next sales forecast.

Sales Forecast													
ITEM 1: (NAME)				ITEM 2: (NAME)				ITEM 3: (NAME)				TOTAL	
UNIT SELLING PRICE				UNIT SELLING PRICE				UNIT SELLING PRICE				DOLLARS	
Month	Estimated		Actual		Estimated	Actual		Estimated	Actual		Estimated	Actual	
	Units	\$	Units	\$		Units	\$		Units	\$		Units	\$
1. January	Sales												
	Returns												
	Net												
2. February	Sales												
	Returns												
	Net												
	Year to Date												
	Sales												
	Returns												
	Net												
3. March	Sales												
	Returns												
	Net												
	Year to Date												
	Sales												
	Returns												
	Net												
4. April	Sales												
	Returns												
	Net												
	Year to Date												
	Sales												
	Returns												
	Net												
12. December	Sales												
	Returns												
	Net												
	Year to Date												
	Sales												
	Returns												
	Net												

Preparing Your Projected Cash Flow

Your cash flow projection is like a moving picture of what you expect your proposed business to do in the periods covered by the projection. It will pull together all the planning you have been doing; it will tell you what problems you face in getting cash to keep your business going; it will be an important aid to you in arranging for financing; and it will serve as a basis for checking your actual business experience with your projections.

Source of Cash Flow Data

If in your planning you have followed the steps suggested in this section of BIG and have prepared work sheets similar to those shown, you are ready to prepare your cash flow. If you have not prepared such work sheets, do so. If any of the prior steps are unclear to you, get someone to help you handle them. And above all remember this—you have made a great many assumptions to get this far in your planning, and some probably will not be valid. When you realize that an assumption is incorrect, you must redo your planning on the basis of the new assumption.

Your forecast of cash flow will be only as correct as the assumptions it is based on; and, to a large extent, the early success of your business depends on the accuracy of your cash flow projection.

Preparing the Cash Flow Projection

Look at the suggested form for your cash flow statement (page 18). In brief, it provides space to show, by month, the amount of cash you had to start the month, the amount of cash you received, the amount of cash you spent, and how much cash you had at the end of the month.

Cash at beginning of period (line 1)

In the first column of the statement, which represents all time before you start your business, the figure is zero. For all other periods (months) the beginning balance is equal to the cash at the end of the prior period.

Cash received (lines 3, 4)

- From cash sales
- From collection of receivables

By your sales forecast you know the dollar amount of sales. Estimate how much of this will be cash sales and write the amounts on line 3 for each period.

You will receive payments on the remaining sales at a later date—you must estimate when. If you expect payments to be made within fifteen days, put one-half of the charge sales in the period they were sold, and one-half on line 4 in the following period. (Remember to add one-half of the preceding period's charge sales.) If you expect that it may take thirty days to collect for your charge sales, put each month's charge sales on line 4 of the following month. Any charge sales you expect to require more than thirty days to collect should be added to the second period, the third period, and so on.

In each case the charge-sale figure used should be reduced by the amount of uncollectible charges you expect to have.

- From other sources (lines 6–15)

Skip over these lines until you have completed the Cash-Paid-Out section.

Cash paid out (lines 16–29)

- For capital equipment

This is the amount you will expect to pay for the equipment, tools, furniture, fixtures, and similar items needed in your business. You know this type of item from your facility-required work sheet. It may be the full payment, or monthly time payments. It does not include repayment of loans you may get to buy capital items. If such a loan is obtained, it is added to cash, and the entire amount of cash payment for equipment is entered in the period in which the loan transaction took place.

The total of all payments for capital equipment should be written on line 17 for the period in which payment is to be made.

- For trade accounts payable

Trade accounts, as used here, means the bills you have for materials and outside services which become a part of the products or services you will sell. You can estimate them from your bills for material and your estimated volume. A part of your estimated calculation must be based on the amount of time that will be required to process materials into salable items. Another factor is the terms on which you buy your materials. For example, if all your material purchases are on a ten-day payment basis, your estimated trade accounts paid would be written on line 18 for the period during which payment is to be made.

- For payroll

Your expected payroll for each month should be written on line 19. The payroll figure should include all deductions taken from employees' pay and the related payroll tax your business will have to pay. (Such deductions and tax reserves should be placed in a separate bank account to insure that they are available when needed.)

- Indirect expense
- Sales expense
- General and administrative expense

You have estimated the foregoing three types of expense in preparing your overhead estimate. They should be written on lines 20, 21, and 22 for each period. Be sure you do not include the payroll portion of overhead that has been handled on line 19.

- For taxes

You have already taken care of the payroll related taxes. The other tax payments will be on your tax calendar. (See Section 5.) Write your estimates for various periods on line 23.

- For interest
- For loan repayments

Skip lines 25 and 26 for the present time.

- For dividends
- For owner's withdrawals

Skip lines 28 and 29 for the present time.

Determination of Capital Required

Add lines 3 and 4 for each period and write the total for each period on lines 5 and 36. Add lines 17 through 23 for each period and write the totals for each period on lines 24 and 37 as a negative figure (in parenthesis). For the pre-start period, there should be all zeros at this point. For the first active month, subtract line 37 from line 36. Write the answer in line 38. This will probably be a negative figure. Write the figure in line 38 on line 35 of the next period. Be sure to put it in parenthesis if it is negative.

For the second period, subtract line 37 from the total of lines 35 and 36 and write the answer in line 38. Continue this operation for all twelve periods.

The figure in line 38, if it is negative, indicates the amount of cash you need to cover payments during the period. If it is not a negative figure, it indicates cash available at the end of the month. It would be convenient to have your end-of-the-month cash balance be at least as much as you plan to pay out during the following month.

Before finishing your projected cash flow statement, you should read the material that follows on methods of financing a small business.

You are now at the point where you must decide how to finance your business. In lines 7, 8, 9, and 10 (11, 12, or 13, if you have other sources of cash), write the amount of cash you expect to get from the various sources.

In lines 25 and 26 write your expected interest and loan payments for each period. Now add lines 5 through 13 by period to get the period cash-received amount and write the answer in line 14. Next, add lines 24 through 32 to get the expected cash payments, and write the answer on line 33. The beginning cash balance plus the estimated cash received is the cash available, which you will write in line 15. This figure, minus the expected payment you will have written in line 33, will give you the projected cash balance at the end of the period. Write this in line 34 for the current period, and on line 1 for the next period. Do this for twelve periods, and your projected cash flow statement will be complete.

Providing Financing

When you have finished your cash forecast so that you know the amount of money you will need by month, you must decide to what sources you will go in order to raise the money. Before doing that, however, ask yourself if your proposed business venture still looks good to you. At what point in the first year will your business be bringing in more cash each month than you will be paying out? Is the amount of money you will have to raise reasonable for a new small business? Do you believe others will be willing to advance you money? Are you willing to invest your own time in the business? If you can answer these questions favorably, then go ahead and attempt to raise your money.

Sources of Financing

The following is a general description of the kinds of sources from which you may be able to raise your required money.

1. *Self-investment*. If you have the necessary cash available to get your business started, this is probably your best available source. Self-investment will eliminate the disadvantages that are present in other methods of financing, as indicated below.
2. *Sale of stock in your business*. The advantages of selling stock as a source of business capital include the following:
 - It avoids the regular drain on cash to meet interest payments.
 - It avoids periodic payments on principal.
 - Stockholders may actively assist you in your business and in contacts with potential customers.

These advantages may be offset somewhat by the disadvantage of giving up a portion of your ownership to the other stockholders. Do not enter into any stock agreement without sound professional advice.

3. *Borrowing*. This is probably the most common means of financing a small business. You may raise your required amount of money in one or more of these ways:
 - A personal loan to you, which may be secured by your business or by your personal assets.
 - Loans to you or to the business from your family, friends, or employees.
 - Advances from your customers.
 - Loans from equipment manufacturers or suppliers.
 - Loans from financial institutions. (These may be either long- or short-term loans and may be made by a bank alone or by governmental and private agencies whose role is to help small businesses get started. Among such agencies are the Small Business Administration (SBA), the Small Business Investment Corporation, MBDA (Minority Business Development Agency), local chambers of commerce, MESBIC (Minority Enterprise Small Business Investment Corporation), and local church, neighborhood, or civic groups.

If you do borrow, your best arrangement would be to secure a "line of credit" in place of borrowing the full amount at one time. This enables you to borrow part of the money as you need it. While it is customary for financial institutions to charge a small amount of interest for the line of credit, it is much less than the interest which would be charged on monies you borrow today but will not use until sometime in the future.

How to Contact Sources of Financing

Your first step should be to determine what funds you will be able to raise yourself. Then you can tell how much, and when, you will need money from other sources. After that, decide on which type of financing you would prefer to use. If it is some type of investing in your business, you should get in touch with an attorney who can give you advice in this area.

If you expect a large amount of your business to come from one or more established large businesses, you may contact them to find out if they have a program to aid small businesses in getting started. Perhaps your product or service may be of sufficient importance to the large business that they would be willing to help you.

Will your business require enough equipment or material to make your supplier interested in financing you? If you think there is a possibility, contact the supplier and present your ideas to him.

Have you any established relationship with a bank? If so, talk over your plans with your contact in the bank.

Are you a member of a minority group? The United States Department of Commerce has set up the Minority Business Development Agency to help you if you are. If you cannot locate a representative of MBDA in your city, write to this address:

Minority Business Development Agency
U.S. Department of Commerce
Washington, D.C. 20230

In most large cities there are other groups who may be able to help you with the actual financing or direct you to sources of financing. The local chamber of commerce or some branch of your city government should know of such groups.

When you make your contacts, be confident. You have carefully considered your proposed business—you know what you want to do, how to do it, and what help you will need to do it. Make a clear, simple, businesslike presentation of your ideas and you will, in most cases, receive a businesslike answer. Be prepared to accept an unfavorable answer, to listen to suggestions, and to consider restrictions or changes in your plans. You will not receive help at every contact, but each one will be an opportunity for you to make someone interested in your business. (See Section 6, "Using Outside Help.")

Your Business Organization

There are things you should consider about your business which, although simple, are often made as hasty decisions. Have you thought about these matters?

- What will the legal form of your new business be—a corporation, a partnership, or a proprietorship?
- What will the name of your business be?
- What bank will you use?
- How will you keep your non-business money and expenses separate from your business accounts?
- What business requirements must you take care of—such as your vendor's number, your employee number, licenses, permits, etc.?
- What types and amounts of insurance will you carry?
- What advertising will you do?
- The extent to which you will need accounting, legal, marketing, and technical information?
- Which business tasks will you delegate to full- or part-time employees?
- What will happen to your business if you become ill or disabled?

Because BIG has been developed as a *general* guide, it cannot give you *specific* help on these points. It can only point out the types of items you should consider and suggest that you make full use of any local, experienced assistance available to you.

Section 2

Business Records

Contents

	<i>Page</i>
Introduction	25
What Are Accounting Records?	25
What Is the Purpose of Accounting Records?	25
How Do You Keep Good Accounting Records?	25
Cash Sales	26
Sales on Credit	28
Sales Returns and Allowances	30
Sales Journal	32
Cash Receipts	32
Cash Discounts on Sales	34
Cash Receipts Journal	34
Accounts Receivable	35
Cash Drawer or Cash Register and Closing	36
Recording the Buying of Merchandise on Account	36
Purchase Returns and Allowances	38
Purchase Journal	40
Cash Disbursements	41
Cash Discount on Purchases	42
Cash Withdrawals by the Owner	42
Petty Cash Fund	43
Cash Disbursements Journal	44
Time Card or Time Sheet	46
Payroll Register or Payroll Journal	48
Employee Earnings Record	50
Payroll Check	52
Journals	52
General Ledger	52
Trial Balance	54
Illustration of Journals, General Ledger, and Trial Balance Work Sheet	55
Posting Transactions	55
Trial Balance Work Sheet	74

Business Records

Introduction

One of the purposes of BIG is to help the owner of a business keep the accounting records necessary to run the business. Some of the records and accounts needed will be different for different kinds of business — depending on whether the business makes a product, buys and sells a product, or sells a service. The records will differ too with the size of business, but the basic ideas are the same. The examples and explanations used here are intended to be a general guide that a business can follow. In some cases, the help of a bookkeeper should be considered. When unusual situations arise or a difficult problem occurs, the help of a professional accountant is invaluable.

Lack of proper records or an inability to understand existing ones is a frequent cause of business failure. A key to good business management is good accounting records.

What Are Accounting Records?

Accounting records are involved with every activity of your business. Each time you buy, sell, order, trade, produce an item, or provide a service, some business record must be created.

What Is the Purpose of Accounting Records?

Accounting records are needed to get information for such things as Social Security, wages and hours of employment, workmen's compensation, income taxes, sales taxes, and so forth. Just as important is their use as a valuable tool in determining how a business is doing and what can be done to improve it.

In addition, when a friend asks you how business is doing, you can answer either good, fair, better, or worse and satisfy his or her curiosity. But, if the Internal Revenue Service wants to collect taxes or if a bank is to make a loan, you must be able to show *exactly* how your business is doing and how you expect it to do in the future. The only way to get these answers is from good accounting records.

How Do You Keep Good Accounting Records?

There used to be a belief among small businessowners that, if they wrote everything down on pieces of paper and kept them in a shoebox, an accountant could come in once a month and straighten out the records. Even if the accountant could "straighten out the shoebox," it still would not produce good accounting records. The shoebox approach harms a business in many ways. It is an inaccurate way of keeping information, which results in errors. Also, it is more costly to hire an accountant to clean up your mistakes than it is to establish proper records in the beginning, and timely information is not immediately available as a tool in management decision-making.

The following examples and explanations will serve as guides to good accounting records.

Cash Sales

When the full price is received at the time of sale, it is known as a *cash sale*.

At the time of a cash sale, a record must be made for the cash received. This record may be a form of receipt or may be rung up on a cash register. The receipt or cash register tape should show the date of the sale, the amount received, and the sales tax on the sale. See the section "Cash Drawer or Cash Register" for what needs to be done at the end of each day.

Sales on Credit

When the full price is not received at the time of sale, it is known as a *charge sale* or a *sale on credit*.

Such sales bring about an *account receivable* to be collected at a later time. The sales on credit must be kept separate from cash sales. A charge-sales slip must be made out even if a cash register is used. The sales slip in this case will serve as support for the difference between the cash taken in and total sales on the cash register tape.

The charge-sales slip should show the following information:

- A preprinted serial number
- The terms of the sale
- The date of the sale
- The name and address of the customer
- The number and the description of each item
- The unit price of each item
- The total amount of the sale
- The amount of cash received at the time of the sale
- A signature of the person who received the merchandise
- A signature of the person who sold the goods

The charge-sales slips are the accounts receivable that are created when a customer purchases an item but doesn't pay cash for it. (Sales slips can be designed so that the same form can be used for both charge and cash sales as in the samples shown.)

At the end of each day the charge sales should be totaled and posted to the customer accounts receivable ledger. The charge-sales tickets should be filed according to the customer's name as a record of what each customer owes.

Sales Returns and Allowances

You may agree to take back goods which were sold to a customer, or you may reduce the price at which a sale was made because of a customer's complaint. *Sales returns and allowances* are decreases in sales.

If it was a cash sale, pay the customer the amount in cash and make out a cash-sales slip, clearly marking it "refund" or "allowance" to correctly account for the reduction in cash. If it was a charge sale, make out a charge-sales slip, again clearly marking it "credit" to show that the customer owes that much less.

Sales Journal

The non-cash sales should be posted to a *sales journal*. The sales journal is a summary of sales sold on credit. The sales journal may be prepared at the same time as the non-cash sales slip and the accounts receivable ledger, or it may be prepared separately.

The sales journal should show the date of the sale, sales slip number, amount of sale, and, if preferred, a breakdown by product of type of sales.

Sales Journal										
Date		Ticket Nos.	Sales		Sales Discounts		Mdse. Returned		Accounts Receivable	
Dec.	1	1-150	1900	50	30	00	20	50	1850	00
	2	151-284	1960	00	20	50	10	00	1929	50
	3	285-410	2175	50	35	50	15	00	2125	00

Cash Receipts

Cash usually comes from three sources:

1. Cash sales to customers.
2. Cash received on account for sales previously made on credit.
3. Miscellaneous sources.

Each time one of these sources of cash is received, a written record must be made. If it is a cash sale, the record may be a cash register tape. If not, the record may be in the form of a receipt. The receipt for cash should be prepared in at least two copies, with the original going to the person making the payment and the other copy being kept for recording the acceptance of cash.

When cash is received on account, the receipt should show the customer's name, and so forth, and be posted as a credit to the customer accounts receivable ledger.

Miscellaneous cash receipts should show the source, amount, and nature of the cash received. Cash receipts should be summarized in a cash receipts journal.

ABC Company

946 West Main
Anytown, USA 12345
Phone 987-6543

Customer's Order No. _____ Phone No. _____ Date DEC-15 19XX

Name SUSAN SMITH

Address 103 SOUTH 18th ANYTOWN, ILL.

Sold By	Cash	C.O.D.	Charge	On Acct.	Mdse. Ret.	Paid Out	Terms
<u>MHC</u>				<input checked="" type="checkbox"/>			
Quantity	Description					Price	Amount
	<u>REC'D ON ACCT.</u>						<u>10 00</u>
TOTAL							

00004

Received By _____

Cash Discounts on Sales

When merchandise is bought on credit, the buyer is expected to pay the seller within the agreed-on time. To encourage the buyer to make payment before the end of the credit period, the seller may allow a deduction from the amount owed. A deduction that the seller allows on the amount of an invoice to encourage the purchaser to make prompt payment is known as a *cash discount*.

When the customer takes advantage of a cash discount, the seller receives a sum less than the sales price recorded on his books. This cash discount is a deduction from sales and is debited on the books of the seller to an account with the title of Sales Discounts.

Cash Receipts Journal

The cash receipts journal is a summary of cash received showing the source from which the cash came.

The cash receipts journal should have the following columns or information:

- Date of receipt of the cash
- Source from which received
- Total amount received
- A column for the amount from cash sales
- A column for the amount received on account
- A column for miscellaneous cash receipts stating the nature of the receipt

Cash Receipts Journal												
Date	Total Cash Received			Sales Discounts		Cash Sales		Received on Account		Other	Explanation	
DEC 1	24	10	02	9	98	400	02	2000	00	19	98	SCRAP SOLD
2	27	30	40	10	10	420	75	23	19	75		
3	26	10	50	10	50	406	00	2200	00	15	00	VENDING MACH.

Cash Drawer or Cash Register and Closing

You should always keep track of how much cash you start with each day. It would be good if you started daily with the same amount, but always count the cash before opening.

At the end of the day, count the cash on hand. Separate the different tickets and count these items. If you are using a cash register having several keys, the tape for that day may show separate totals for each type of ticket—charge sales, cash sales, etc. To balance with the tape of the cash register, it is important that all transactions are recorded on the cash register and all the tickets are filled out properly. After arriving at the correct balance (see illustration), write the totals for cash collected, non-cash sales, sales discounts, and sales returns in the sales and cash receipts journals. Do this every day to maintain a record of each day's transactions.

Balancing and summarizing the day's transactions may be done as follows:

(1)	Total cash in drawer or register		<u>\$4,801.50</u>
(2)	Cash sales		\$1,078.50
(3)	Collections on accounts receivable	\$3,700.50	
(4)	Less — cash discounts allowed	<u>98.50</u>	<u>3,602.00</u>
(5)	Cash sales of scrap		<u>21.00</u>
(6)	Amount to be deposited		<u>\$4,701.50</u>
(7)	Working cash fund (1-6)		<u>\$ 100.00</u>
(8)	Cash sales (as above)		\$1,078.50
(9)	Charge sales		<u>5,781.50</u>
(10)	Total sales (8 + 9)		<u>\$6,860.00</u>
(11)	Returned merchandise		<u>\$ 90.00</u>

Keep a file for each set of tickets, and at the end of the day put that day's tickets in their respective file. It is important that all cash totals and related slips agree with the cash on hand. The non-cash sales tickets are very important since you want to keep a record of who owes money (accounts receivable).

Recording the Buying of Merchandise on Account

Goods carried in stock for sale to customers are known as *merchandise*. Merchandise may be purchased from a salesperson, a wholesaler, manufacturer, or from a catalog. When merchandise is purchased, prepare a form known as a *purchase order*. The purchase order should be prepared in more than one copy. The purchase order should show from whom the merchandise is being purchased, the date ordered, the method of shipment, the terms of payment, the quantity ordered, a description of the item, the cost of each item, total cost of all items ordered, desired date of receipt of the merchandise, and the name and signature of the person ordering the merchandise.

The original copy of the purchase order should be given to the person from whom the merchandise is being purchased. You should maintain a duplicate copy or copies to be used as a record of merchandise on order and to check the merchandise when received.

ABC Company
 946 West Main
 Anytown, USA 12345
 Phone 987-6543

Purchase Order

No. **1228**
 THIS NUMBER MUST APPEAR ON
 ALL INVOICES, PACKAGES AND
 SHIPPING PAPERS.

Vendor

OAK PANEL COMPANY
1300 PEACHTREE ST.
ATLANTA, GA. 00632

PLEASE ENTER THIS ORDER
 SUBJECT TO THE TERMS,
 CONDITIONS AND INSTRUCTIONS.

Date <i>Nov. 1, 19XX</i>				Date Needed <i>Nov. 15, 19XX</i>		Special Instructions			
Date	Date	Date	Date	F.O.B. <i>ATLANTA</i>		Terms <i>2-10/11-30</i>	Ship Via <i>SOUTH/BLUES</i>		
Qty. Rec.	Qty. Rec.	Qty. Rec.	Qty. Rec.	Quantity	Unit	Description	Unit Cost	Total	
				<i>1000</i>	<i>SHTS</i>	<i>OAK PANEL</i> <i>No. 345</i>	<i>2.00</i>	<i>2,000.00</i>	
						<i>USE TAX</i>		<i>80.00</i>	
								<i>2,080.00</i>	

Ordered By *Jenny Atal*

When the merchandise is received, it should be checked to see that it is in good condition and agrees with the order. The receipt of the merchandise should be noted on a copy of the purchase order or on a *receiving report*, and the person receiving the merchandise should sign for it.

When the merchandise is received, or soon after, you should get a bill or invoice requesting payment. These invoices vary from business to business, but most invoices include the following:

- The name and address of the one from whom the merchandise was purchased
- The name and address of the purchaser
- The date of the invoice
- The seller's invoice number
- The method of shipment
- The terms of payment
- The buyer's purchase order number
- The quantity, description, and unit price of items purchased
- The total cost of each item and the total of the invoice

When you receive this invoice it is important to confirm that the items ordered have been received and that the proper amount has been charged. You should, therefore, perform the following:

1. Compare the invoice with the purchase order to see that the items on the invoice agree with those on the purchase order.
2. Examine the receiving report to see if all items were delivered.
3. Check the invoice to see that quantities and prices are in agreement with the purchase order.
4. Check the accuracy of the multiplication on each line and the addition of the total column.
5. Verify the computation of the sales tax and discount, if applicable.
6. After steps one through five above have been completed, approve the invoice for payment in writing on the face of the invoice.

At this point the invoice may be paid or entered in the purchase journal. A purchase journal is necessary when items are not paid promptly or are numerous.

Purchase Returns and Allowances

The buyer of merchandise may be allowed credit by the seller for the return of part or all of the merchandise purchased. He may also be allowed credit if the merchandise received was not up to quality or was damaged.

The buyer usually receives a credit memorandum from the seller showing the amount of the purchase returned or the purchase allowance. The credit memorandum should be applied against any amounts owed the vendor or a refund should be requested. The purchase order form properly marked "returned goods" may be used as a record to be sure credit is received.

Cash Disbursements

All bills, purchases, expenses, etc., should be paid by check. No check should be written until there is proof that the service or merchandise has been received and is satisfactory. When a check is written, the purpose for payment should be stated on the check and the check stub. The bill, invoice, or proof that the service or merchandise has been received should be clearly marked "paid," dated, and the check number listed to prevent duplicate payment. The paid bill should then be filed in a "paid" file in alphabetical order for future reference. After the check has been written, it should be recorded in a cash disbursements journal for the purpose of summarizing the various types of expenses paid.

ABC Company 946 West Main Anytown, USA 12345	<table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 15%;">Date</th> <th style="width: 35%;">Invoice</th> <th colspan="2" style="width: 40%;">Amount</th> </tr> </thead> <tbody> <tr> <td>Nov. 15</td> <td>3456</td> <td style="text-align: right;">2,300</td> <td style="text-align: right;">00</td> </tr> <tr> <td> </td> <td> </td> <td> </td> <td> </td> </tr> <tr> <td> </td> <td> </td> <td> </td> <td> </td> </tr> <tr> <td> </td> <td> </td> <td> </td> <td> </td> </tr> </tbody> </table>	Date	Invoice	Amount		Nov. 15	3456	2,300	00													<table style="width: 100%;"> <tr> <td style="width: 50%; border-bottom: 1px solid black;">2-4</td> </tr> <tr> <td style="border-bottom: 1px solid black;">135</td> </tr> <tr> <td>No. 0030</td> </tr> </table>	2-4	135	No. 0030
Date	Invoice	Amount																							
Nov. 15	3456	2,300	00																						
2-4																									
135																									
No. 0030																									
AMOUNT <u>Two thousand two hundred fiftyeight + ⁴⁹/₁₀₀</u> DOLLARS																									
<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <th style="width: 100%;">CHECK NO.</th> </tr> <tr> <td style="text-align: center;">0030</td> </tr> </table>	CHECK NO.	0030	<u>OAK PANEL COMPANY</u> <u>1300 PEACHTREE ST.</u> <u>ATLANTA, GA. 00632</u>	<table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 15%;">Date</th> <th style="width: 25%;">Gross</th> <th style="width: 20%;">Discount</th> <th style="width: 40%;">Net</th> </tr> </thead> <tbody> <tr> <td>DEC. 5</td> <td style="text-align: right;">2300 00</td> <td style="text-align: right;">41 60</td> <td style="text-align: right;">2258 40</td> </tr> </tbody> </table>	Date	Gross	Discount	Net	DEC. 5	2300 00	41 60	2258 40													
CHECK NO.																									
0030																									
Date	Gross	Discount	Net																						
DEC. 5	2300 00	41 60	2258 40																						
PAY TO THE ORDER OF		ABC COMPANY <u>Jerry Otal</u>																							
FIRST NATIONAL BANK—ANYTOWN, USA 12345 MAGNETIC NOS.																									

Cash Discount on Purchases

To encourage the buyer to make payment for merchandise before the end of an agreed-upon credit period, a seller may allow a deduction from the amount owed. When the buyer takes advantage of this discount, the payment is less than the purchase price recorded on your books in Accounts Payable. The cash discount is a deduction from purchases and is credited on the books to an account with the title of Discount on Purchases.

Cash Withdrawals by the Owner

A person who is the sole owner of a business often withdraws cash from the business as needed for personal use. This represents a withdrawal of an asset from the business. Withdrawals by the proprietor are not deductible expenses for federal income tax purposes. Because of this, withdrawals of cash or other assets by the proprietor are not charged to an expense account. They should be charged to an account known as a *drawing account*.

Petty Cash Fund

Good business practice requires that two rules be closely followed when dealing with cash:

1. All cash receipts must be deposited in the bank each day and not be used to pay expenses.
2. All expenses should be paid by check.

Every business, however, has many small bills that are more easily paid by cash. It is just not practical, for example, to pay messengers or buy postage stamps with checks. These cash payments, which are exceptions to rule two, require that a special cash fund be used for small expenses. This type of fund is called a *petty cash fund*.

To create such a fund:

1. Estimate the amount of small expenses that will be paid in cash during an average two-week to one-month period.
2. Cash a business check for this amount and keep all the money in a separate place, controlled by only one person. This fund should remain at that fixed amount and not change from one period to another.
3. Each time an expense is paid out of this fund a bill marked "paid" or a signed receipt for the amount paid should be kept with the money so that at all times the total of bills or receipts and the money still in the fund will equal the fixed amount of the petty cash fund.
4. Remove all paid bills and signed receipts when the fund becomes low, and write a business check for the total of these items. When this check is cashed, it replaces the money used and brings the balance of cash in the fund to the original fixed amount. When the fund is reimbursed, the various expense accounts should be charged for the amounts spent.

Petty Cash Disbursement	
No. _____	Date <u>DEC. 1</u> 19 <u>XX</u>
	\$ <u>1.02</u>
TO <u>POSTMAN</u>	
Amount <u>One + $\frac{02}{100}$</u> _____	DOLLARS
For <u>POSTAGE</u>	
Account Number <u>POSTAGE</u>	
Approved By <u>Jerry Atal</u>	Received Payment <u>Mr. Postman</u>

Cash Disbursements Journal

The *cash disbursements journal* should show the following information:

- Check number
- To whom written
- Date written
- Gross amount
- Discount taken
- Net amount
- A distribution to the expense or account affected

Time Card or Time Sheet

Each employee of the business should prepare a *time card* or *time sheet* that covers a specific pay period such as one week, two weeks, etc. At the end of this period of time, the following steps should be performed.

1. The time cards are examined for records of tardiness, leaving early, absence, etc.
2. The regular hours are extended into the Hours column.
3. The amount of overtime for each day is figured and entered on the time record.
4. The regular hours and overtime hours are totaled separately.
5. The rates for regular time and overtime are entered, and the earnings are computed.
6. The hours and earnings for regular and overtime are then added to show total hours and total earnings.
7. The different deductions are figured and then the net amount to be paid is determined.

After completion of these steps, the next records to be prepared are the *payroll checks*, *payroll register* or *payroll journal*, and the *employee earnings records*.

No. _____ Name JOHN DOE

Pay Period Ending DEC. 12, 19XX

Reg. Hrs.	Rate	Amount	FICA	No. of Exempt.
79	1.60	121.60	6.57	M-2
OT Hrs.	Rate	Amount	Fed. WH	Total Earn.
2	2.40	4.80	9.93	126.40
Total		Amount	State WH	Total Ded.
81		126.40	4.00	30.40
			Other	Net
			INS. 10.00	96.00

1	NOV. 29 7:00 AM	NOV. 29 11:30 AM	NOV. 29 12:00 PM	NOV. 29 3:30 PM			8
2	NOV. 30 7:00 AM	NOV. 30 11:30 AM	NOV. 30 12:00 PM	NOV. 30 3:30 PM			8
3	DEC. 1 6:59 AM	DEC. 1 11:31 AM	DEC. 1 12:01 PM	DEC. 1 3:31 PM			8
4	DEC. 2 7:30 AM	DEC. 2 11:30 AM	DEC. 2 12:00 PM	DEC. 2 3:30 PM			7 1/2
5	DEC. 3 7:00 AM	DEC. 3 11:30 AM	DEC. 3 12:00 PM	DEC. 3 4:30 PM			9
6							
7							
8	DEC. 6 7:00 AM	DEC. 6 11:30 AM	DEC. 6 12:00 PM	DEC. 6 3:30 PM			8
9	DEC. 7 6:50 AM	DEC. 7 11:30 AM	DEC. 7 12:00 PM	DEC. 7 3:35 PM			8
10	DEC. 8 7:00 AM	DEC. 8 11:30 AM	DEC. 8 12:00 PM	DEC. 8 3:30 PM			8
11	DEC. 9 7:30 AM	DEC. 9 11:30 AM	DEC. 9 12:00 PM	DEC. 9 3:30 PM			7 1/2
12	DEC. 10 7:00 AM	DEC. 10 11:30 AM	DEC. 10 12:00 PM	DEC. 10 4:30 PM			9
13							
14							
	IN	OUT	IN	OUT	IN	OUT	

Total Hours Are Correct

Totals 81

Jerry Otal

Signature

Payroll Register or Payroll Journal

After completing the time cards, the payroll register or payroll journal should be completed using the information from the time cards. Simple forms are available with which you can write in the payroll check and record amounts in the payroll journal and the employee earnings records all at the same time. These forms save the time of writing the same information more than once.

The total earnings figure from each time card is entered in the Total Earnings column of the payroll journal opposite the name of the employee. The section headed Deductions is used to enter the amounts that are deducted from the employees' earnings. The column headed FICA Tax is used for Social Security. The Social Security tax can be computed by formula or obtained from a government table.

The column headed Federal Income Tax is used for the federal income tax withheld from each employee's earnings. This can also be obtained from a government table. This same thing would be done for state and city income taxes. The column headed Other is used to enter such items as deductions for purchase of savings bonds, union dues, and so forth. The space headed Net Pay is used to record the amount due each employee.

After the entries for all employees have been made, each of the amount columns is totaled. To check these additions compare the total of the Total Earnings column with the sum of the totals of the Net Pay column and the Deductions columns.

Employee Earnings Record

A detailed account is kept for the payments made to each employee. This record, known as the *employee earnings record*, is kept on cards or sheets. A separate card or sheet is kept for each employee. This record is made with divisions for totals every three months because the federal, state, and some city governments require reports on a quarterly basis.

The amount columns of the employee earnings record are the same as the amount columns of the payroll journal. The quarterly totals line provides space for the totals for the quarter, and the final quarter provides space for entering the totals for the year. The yearly totals are needed for preparation of annual reports to the federal, state, and some city governments.

Name JOHN DOE

Employee Earnings Record

Address 302 So. Sycamore, Anytown, U.S.A.

Telephone 334-6272

Income Tax Status M-2

Soc. Sec. No. 334-52-6272

No. of Exempts. 2

Exempt From FICA Inc Tax

Fixed Deductions 1MS.
10.00

Reason

Effective Date JAN. 1, 19XX

Period Ending

Date of Exempt. Cert. JAN. 1, 19XX

Name

Net Pay

JOHN DOE

96.00

Time Worked

Check No. 1053

81

Cumulated Earnings

Reg. 121.60

1

O.T. 4.90

2

Total 126.40

3

FICA 6.57

4

Fed WH 9.93

5

State WH 4.00

6

Other 10.00

7

Total 30.40

8

9

9

10

10

11

11

12

12

13

13

14

14

Qtrly. Total

Yr. to Date

1

1

2

2

Payroll Check

All payments to employees for work done should be by check. It is helpful to use a different type of check for payroll than that for general disbursements. If, however, the same type of check is used for both payroll and general disbursements, additional information should be entered on the check stub. This information should include total earnings, payroll deductions, and so forth.

The amount of the payroll check should be the same as the Net Pay column of the payroll journal and employee earnings record.

Journals

A book in which any of the records of a business are first written is called a *journal*. There are many kinds of journals. The basic types are as follows:

- General journal
- Sales journal
- Purchase journal
- Cash receipts journal
- Cash disbursements journal
- Payroll journal

Every journal has two parts — the debit part and the credit part. For example, the general journal usually has two amount columns: the left-hand amount column is called the *debit* column; the right-hand amount column is called the *credit* column.

The general journal is used to record openings, closings, corrections, and unusual entries that cannot be recorded in the special types of journals. See page 56 for a sample general journal form.

General Ledger

As business is transacted, there will be changes in the asset, liability, and proprietorship accounts. Entries will have to be made in the various journals to record these changes.

The entries in these various journals do not bring together in one place all the information about one item, such as cash, accounts receivable, and so forth. For this reason, the items from the various journals are sorted into forms known as *accounts*. An account is a device for grouping and summarizing the entries in the various journals.

A group of these accounts is known as a *general ledger*. The general ledger may be a bound book or a loose-leaf book. It may also be a group of ledger sheets or cards filed in a tray or cabinet.

The difference between the debits (left side) and credits (right side) of a general ledger account is known as the *account balance*. If an account contains only one entry, this single amount is the account balance. If it contains entries on both sides, the difference between the totals of each side is the account balance.

JOHN DOE										
Name ABC Company Anytown, USA 12345										
Period Ending	Hrs.	Regular	O.T.	Total	FICA	Fed WH	State WH	Other	Total	Net Pay
DEC 12	81	121.60	4.80	126.40	6.57	9.83	4.00	10.00	30.40	96.00

Detach and Retain Stub

<p>ABC Company 946 West Main Anytown, USA 12345</p>	<p>Payroll Check</p>	<p>1043</p>	<p>2.4 135</p>
<p>Pay To The Order Of <u>JOHN DOE</u></p>	<p>Date <u>DEC. 17</u> 19 <u>XX</u></p>	<p><u>\$96.00</u></p>	<p>Dollars</p>
<p><u>NINETY SIX + 00/100</u></p>	<p>ABC Company</p>	<p><u>John Doe</u></p>	<p>Magnetic Nos.</p>
<p>First National Bank - Anytown, USA 12345</p>	<p>ABC Company</p>	<p><u>John Doe</u></p>	<p></p>

The balance of each liability, income, and proprietor's capital account is usually a *credit* balance. The balance of each asset and expense account is usually a *debit* balance. Assets are anything owned by the business, and liabilities are amounts due to others. The difference between them is known as the *owner's capital*. Income accounts are used to indicate what the business charges others, such as sales, purchase discounts, interest received, and so forth. Expense accounts show what others charge the business, such as purchases, wages, rent, and so forth. See page 61 for a sample general ledger form.

Trial Balance

Bookkeeping records are valuable only to the extent that they are accurate. Bookkeepers should be careful to avoid errors, and they should use methods which will help them detect errors. One method of detecting or checking for errors which occur is the use of a *trial balance*. See page 75 for a sample trial balance form.

The trial balance is composed of three columns: account title, debit, and credit columns. Each account balance in the general ledger is entered in the appropriate column of the trial balance. After all balances have been entered, the sum of the debits should equal the sum of the credits. If they do not, proceed as follows (if the error has not been found in the first step, continue on to the next steps until it is located):

1. Add the debit and credit columns of the trial balance again.
2. Find the difference between the sum of the debits and credits on the trial balance and look in the ledger and the journals for that amount. The amount may have been omitted from the trial balance or an amount from a journal may not have been posted to the ledger.
3. Divide the difference between the sum of the debits and credits on the trial balance by two. Look in the ledger for that amount to see if it has been posted in the wrong column. A \$100 debit posted in error as a credit, for example, would result in a \$200 difference.
4. Divide the difference between the sum of the debits and credits of the trial balance by nine. If the difference can be divided evenly by nine, figures in an amount posted to the general ledger may have been switched (transposed); for example, \$92 may have been posted in error as \$29. This would result in a difference of \$63 (which can be evenly divided by nine).
5. Trace the balances on the trial balance back to the ledger account to locate an error made in copying the amount on the trial balance.
6. Check the adding and subtracting done to arrive at the ledger account balances.
7. Trace the postings of each journal to the general ledger accounts by checking off each posting. You may find that an item was posted twice, not posted at all, posted incorrectly, or entered in the wrong column, that is, a debit posted as a credit.
8. Examine the journal and the ledger account to see that each item is checked twice or checked at all. All postings have now been retraced and the error should have been located.
9. If the error was not located, "refoot" and "crossfoot" each journal. To refoot is to add each column again. To crossfoot is to see that the totals of all columns of the journal balance correctly. (For example, check to see that in the payroll journal, the Gross Pay column equals the sum of the Net Pay column plus all the deduction columns.)

Illustration of Journals, General Ledger, and Trial Balance Work Sheet

George New purchased a lumber yard on September 30, 19XX. Mr. New plans to set up a personal bookkeeping system. He has prepared the following lists of things owned and amounts owned:

Things owned (assets):	
Cash	\$ 5,900
Accounts receivable	14,300
Merchandise inventory	16,500
Shop equipment	1,500
Office equipment	1,200
Trucks	<u>12,200</u>
	<u>\$51,600</u>
Amounts owed (liabilities):	
Note payable	<u>\$30,000</u>

Prepare the opening journal entry for Mr. New and post the entry to the proper general ledger account.

Posting Transactions

At the close of business on October 31, 19XX, Mr. New prepares to post his general ledger for the month. He performs the following steps:

1. Prepares to check his sales, cash receipts, payroll, purchase, and cash disbursements journals.
2. Totals and crossfoots each journal.
3. Checks crossfooting again before posting to be sure that they are balanced.
4. Enters each figure in the proper general ledger account.
5. Adds or subtracts the entries in each general ledger account to the beginning balance to obtain new balance or ending balance at October 31, 19XX.

The complete set of journals and general ledger accounts follow (pp. 56–73).

Account No. *CASH*

GENERAL LEDGER

Date 19 <u>XX</u>	Explanation	Reference	Balance	
			Debit	Credit
SEPT 30	OPENING BALANCE	GT	5900 00	5900 00
OCT 31		CR	7256 47	
31		PRJ		602 17
31		CD		4387 75
				8666 55

Account No. *ACCOUNTS RECEIVABLE*

GENERAL LEDGER

Date 19 <u>XX</u>	Explanation	Reference	Balance	
			Debit	Credit
SEPT 30	OPENING BALANCE	GT	14300 00	14300 00
OCT 31		ST	5317 39	
31		CR		6563 67
				13053 72

Account No. *MERCHANDISE INVENTORY*

GENERAL LEDGER

Date 19 <u>XX</u>	Explanation	Reference	Balance	
			Debit	Credit
SEPT 30	OPENING BALANCE	GT	16500 00	16500 00
OCT 31		GT 4	452 00	16952 00

Account No. *Accumulated Dept. Shop E* GENERAL LEDGER

Date 19 <u>XX</u>	Explanation	Reference	Debit		Credit		Balance		
							Debit	Credit	
<i>Oct 31</i>		<i>GT 3</i>			<i>25 00</i>				<i>25 00</i>

Account No. *Accumulated Dept. Office E* GENERAL LEDGER

Date 19 <u>XX</u>	Explanation	Reference	Debit		Credit		Balance		
							Debit	Credit	
<i>Oct 31</i>		<i>GT 3</i>			<i>20 00</i>				<i>20 00</i>

Account No. *Accumulated Dept. Trucks* GENERAL LEDGER

Date 19 <u>XX</u>	Explanation	Reference	Debit		Credit		Balance		
							Debit	Credit	
<i>Oct 31</i>		<i>GT 3</i>			<i>255 00</i>				<i>255 00</i>

Account No. *Accrued Payroll Taxes - Federal* GENERAL LEDGER

Date 19 <u>XX</u>	Explanation	Reference	Debit	Credit	Balance	
					Debit	Credit
<i>OCT 31</i>		<i>PRJ</i>		<i>37 13</i>		
<i>31</i>		<i>PRJ</i>		<i>50 00</i>		<i>87 13</i>
<i>31</i>		<i>GJ 1</i>		<i>37 13</i>		<i>124 26</i>

Account No. *Accrued Payroll Taxes - State* GENERAL LEDGER

Date 19 <u>XX</u>	Explanation	Reference	Debit	Credit	Balance	
					Debit	Credit
<i>OCT 31</i>		<i>PRJ</i>		<i>15 00</i>		<i>15 00</i>

Account No. *Accounts Payable* GENERAL LEDGER

Date 19 <u>XX</u>	Explanation	Reference	Debit	Credit	Balance	
					Debit	Credit
<i>OCT 31</i>		<i>PJ</i>		<i>5409 32</i>		
<i>31</i>		<i>CD</i>	<i>3403 32</i>			<i>2006 00</i>

Account No. *NOTE PAYABLE* GENERAL LEDGER

Date 19 <u>XX</u>	Explanation	Reference	Debit		Credit		Balance	
							Debit	Credit
SEPT 30	OPENING BALANCE	GT			30000 00			30000 00
OCT 31		CD	35000					29650 00

Account No. *GEORGE NEW - CAPITAL* GENERAL LEDGER

Date 19 <u>XX</u>	Explanation	Reference	Debit		Credit		Balance	
							Debit	Credit
SEPT 30	OPENING BALANCE	GT			21600 00			21600 00

Account No. *GEORGE NEW - DRAWING* GENERAL LEDGER

Date 19 <u>XX</u>	Explanation	Reference	Debit		Credit		Balance	
							Debit	Credit
OCT 31		CD	500 00					500 00

SALES

GENERAL LEDGER

Account No.

Date 19 <u>XX</u>	Explanation	Reference	Debit	Credit	Balance	
					Debit	Credit
<i>OCT 31</i>		<i>ST</i>		<i>5735 19</i>		
<i>31</i>		<i>CR</i>		<i>1287 80</i>		<i>7022 99</i>

SALES DISCOUNTS

GENERAL LEDGER

Account No.

Date 19 <u>XX</u>	Explanation	Reference	Debit	Credit	Balance	
					Debit	Credit
<i>OCT 31</i>		<i>ST</i>	<i>130 00</i>			
<i>31</i>		<i>CR</i>	<i>120 00</i>		<i>250 00</i>	

MERCHANDISE RETURNS SALES

GENERAL LEDGER

Account No.

Date 19 <u>XX</u>	Explanation	Reference	Debit	Credit	Balance	
					Debit	Credit
<i>OCT 31</i>		<i>ST</i>	<i>287 80</i>			
					<i>287 80</i>	

SALE SCRAP

GENERAL LEDGER

Account No.

Date 19 <u>XX</u>	Explanation	Reference	Debit	Credit	Balance	
					Debit	Credit
OCT 31		CR		25 00		25 00

PURCHASES

GENERAL LEDGER

Account No.

Date 19 <u>XX</u>	Explanation	Reference	Debit	Credit	Balance	
					Debit	Credit
OCT 31		PJ	4666 00			4666 00
				452 00		4214 00

PURCHASE DISCOUNTS

GENERAL LEDGER

Account No.

Date 19 <u>XX</u>	Explanation	Reference	Debit	Credit	Balance	
					Debit	Credit
OCT 31		CD		54 72		54 72

Account No. *SALARIES* GENERAL LEDGER

Date 19 <u>XX</u>	Explanation	Reference	Debit	Credit	Balance	
					Debit	Credit
<i>OCT 31</i>		<i>PR</i>	<i>714 05</i>			<i>714 05</i>

Account No. *PAYROLL TAX EXPENSE* GENERAL LEDGER

Date 19 <u>XX</u>	Explanation	Reference	Debit	Credit	Balance	
					Debit	Credit
<i>OCT 31</i>		<i>GT 1</i>	<i>37 13</i>			<i>37 13</i>

Account No. *FREIGHT* GENERAL LEDGER

Date 19 <u>XX</u>	Explanation	Reference	Debit	Credit	Balance	
					Debit	Credit
<i>OCT 31</i>		<i>RJ</i>	<i>80 11</i>			<i>80 11</i>

Account No. *SALES TAX EXPENSE* GENERAL LEDGER

Date 19 <u>XX</u>	Explanation	Reference	Balance	
			Debit	Credit
<i>Oct 31</i>		<i>PJ</i>	<i>400 00</i>	<i>400 00</i>

Account No. *INSURANCE EXPENSE* GENERAL LEDGER

Date 19 <u>XX</u>	Explanation	Reference	Balance	
			Debit	Credit
<i>Oct 31</i>		<i>PRJ</i>		<i>9 75</i>
<i>31</i>		<i>CD</i>	<i>19 50</i>	

Account No. *TRAVEL EXPENSE* GENERAL LEDGER

Date 19 <u>XX</u>	Explanation	Reference	Balance	
			Debit	Credit
<i>Oct 31</i>		<i>CD</i>	<i>19 65</i>	

Trial Balance Worksheet

Mr. New would now like to know if he has posted the transactions correctly and if the general ledger account balances are correct. In order to obtain this information and prepare financial statements for the month of October 19XX, he prepared a *trial balance work sheet*.

The trial balance worksheet contains the following.

1. Debit and credit columns for the balance from each general ledger account. The sum of the debits and credits should equal; if they do not, Mr. New will have to locate the error before proceeding.
2. Debit and credit columns for adjustments to the general ledger account balances.
 - a. The first observation that Mr. New makes is that there is no payroll tax expense. He examines the payroll journal and notes that the employees' share of FICA taxes was \$37.13. Mr. New writes a journal entry in the general journal for the same amount to record his portion of the expense, and posts the amounts to the trial balance work sheet and the general ledger accounts.
 - b. Mr. New also notes that no rental expense for the lumber yard has been recorded. He prepares a general journal entry to record the unpaid rent, and posts this amount to the trial balance work sheet and the general ledger accounts.
 - c. Mr. New does not maintain perpetual inventory records, nor does he count his inventory at the end of each month. His cost of merchandise is generally 60 percent of the sales price. Sales for the month of October were \$7,023 times 60 percent, which equals \$4,214 for the cost of merchandise sold. The purchase account has \$4,666 as purchases for the month, so the \$4,214 is subtracted to obtain the \$452 representing the merchandise purchases which are estimated as being added to the inventory. Mr. New records a general journal entry for this amount and posts it to the work sheet and the general ledger accounts.

Mr. New will count his inventory every six months and adjust to the physical count at that time.
 - d. No depreciation expense has been recorded, so Mr. New prepares a schedule of equipment and calculates the depreciation expense. He then prepares a general journal entry to record the depreciation and posts to the work sheet and the general ledger accounts.
3. Debit and credit columns are provided for income and expense accounts. The balances from the Per Books and Adjustments columns are extended into these columns for preparation of the income statement. The difference between the sum of the debits and credits should be the net income or loss for the period.
4. Debit and credit columns are provided for the balance sheet accounts. The same procedures are followed as for the income and expense accounts. The difference between the sum of the debits and credits should equal the net income, which is an addition or deduction to the capital account of Mr. New.

Mr. New may stop at this point and utilize the information for his internal purposes, or he may prepare formal financial statements. The preparation of such statements and the need for them is explained and illustrated in Section 4.

A trial balance work sheet is illustrated on the following pages (pp. 75–78).

George New Lumber Company

Trial Balance Work Sheet

October 31, 19XX

Account	PER BOOKS		ADJUSTMENTS		INCOME & EXPENSE		BALANCE SHEET	
	OCTOBER 31 DEBIT	OCTOBER 31 CREDIT	OCTOBER 31 DEBIT	OCTOBER 31 CREDIT	OCTOBER 31 DEBIT	OCTOBER 31 CREDIT	OCTOBER 31 DEBIT	OCTOBER 31 CREDIT
CASH	8666 55						8666 55	
ACCOUNTS RECEIVABLE	13053 72						13053 72	
MERCHANDISE INVENTORY	16570 00	① 152 00					16952 00	
SHOP EQUIPMENT	1500 00						1500 00	
ACCUMULATED DEPRECIATION			④ 25 00					25 00
OFFICE EQUIPMENT	1200 00						1200 00	
ACCUMULATED DEPRECIATION			④ 20 00					20 00
TRUCKS	12200 00						12200 00	
ACCUMULATED DEPRECIATION			④ 255 00					255 00
NOTE PAYABLE		29650 00						29650 00
ACCOUNTS PAYABLE		2006 00						2006 00
ACCURUED PAYROLL TAXES - FEDERAL		87 13	① 37 13					124 36
ACCURUED PAYROLL TAXES - STATE		15 00						15 00
ACCURUED RENT			② 500 00					500 00
GEORGE NEW, CAPITAL		21600 00						21600 00
GEORGE NEW, DRAWING	500 00						500 00	
SUBTOTAL	53620	27 53358	452 00	837 13			54072 27	54195 26

George New Lumber Company

Trial Balance Work Sheet

October 31, 19XX

ACCOUNT	PER BOOKS		ADJUSTMENTS		INCOME EXPENSE		BALANCE SHEET	
	OCTOBER 31		OCTOBER 31		OCTOBER 31		OCTOBER 31	
	DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT
BAL. FWD.	53620	27 53558 13	452 00	837 13			54072 27	54195 26
SALES		7022 99				7022 99		
SALES DISCOUNTS	250 00				250 00			
MERCHANDISE RETURNS - SALES	287 80				287 80			
SALE SERAP		25 00				25 00		
PURCHASES	4666 00			(3) 452 00	4214 00			
PURCHASE DISCOUNTS		54 72				54 72		
SALARIES	714 05				714 05			
PAYROLL TAXES				(D) 37 13	37 13			
FREIGHT	80 11				80 11			
LIGHT AND POWER	29 15				29 15			
WATER	4 00				4 00			
TELEPHONE	23 31				23 31			
TRUCK GAS AND OIL	34 95				38 95			
ADVERTISING	91 15				91 15			
OFFICE SUPPLIES	22 90				22 90			
SUBTOTAL	59827 69	60460 64	489 13	1289 13	5792 55	7102 71	54072 27	54195 26

General Journal

Date	Name of Account	Post Ref.	Debit	Credit
OCT 31	Payroll Tax Expense		37 13	
	Accrued Payroll			
	Taxes - Federal			37 13
	To Accrue Employer			
	Portion of FICA Expense			

General Journal

Date	Name of Account	Post Ref.	Debit	Credit
OCT 31	Rent Expense		500 00	
	Accrued Rent			500 00
	To Accrue Rent for			
	Month of October			

General Journal

Date	Name of Account	Post Ref.	Debit	Credit
OCT 31	Merchandise Inventory		452 00	
	Purchases			452 00
	To Adjust Merchandise			
	Inventory through purchases			
	for changes in inventory			
	in October < Cost of Goods			
	Sold equals 60% of Sales >			

General Journal

Date	Name of Account	Post Ref.	Debit	Credit
OCT 31	Depreciation Expense		300 00	
	Accum. Depr. - Shop E.			25 00
	Accum. Depr. - Office E.			20 00
	Accum. Depr. - Trucks			255 00
	To Record Monthly			
	Depreciation Expense			

Kind of Property	Date Acquired	Method	Rate	Cost		Annual Depreciation		Monthly Depreciation	
				\$		\$		\$	
SHOP EQUIPMENT	SEPT 30, XX	S.L.	5 YRS	1500	00	300	00	25	00
OFFICE EQUIPMENT	SEPT 30, XX	S.L.	5 YRS	1200	00	240	00	20	00
TRUCKS	SEPT 30, XX	S.L.	4 YRS	12200	00	3060	00	255	00
				14900	00	3600	00	300	00

Section 3

Chart of Accounts

Chart of Accounts

Every business transaction affects one or more accounts of the general ledger that was described in Section 2. In identifying the accounts involved, the use of a numbering system can save time and help in avoiding possible error. Such a numbering system is called a *chart of accounts*. A block of numbers is assigned to each type of account and numbers within that block are used for all the accounts of that type. This can be seen in the sample chart which follows.

The span of numbers assigned should be big enough so that as new accounts are needed, they can be given numbers within the proper group. Some businesses will have need for accounts that others will not use. A retail business, for example, will not use accounts for various material, labor, and expenses that would be used by a business that makes a product. In each instance the accounts should be designed to best serve the individual case.

The chart which follows is intended for a nonmanufacturing business. It would permit the addition of many more accounts in each group if they became necessary in the future.

	<u>Account No.</u>
BALANCE SHEET (Accounts 1 through 500)	
ASSETS (1-300)	
Cash (1-50)	
Petty Cash (Cash on Hand)	11
Cash in Bank — General (Regular Bank Account)	21
Cash in Bank — Payroll (Payroll Bank Account)	31
Receivables From Others (51-100)	
Notes Receivable	51
Accounts Receivable — Customers	61
Accounts Receivable — Others	71
Inventories (101-150)	
Inventory — Goods for Sale	101
Inventory — Supplies	121
Prepaid Expenses (151-200)	
Prepaid Advertising	151
Prepaid Insurance	161
Prepaid Interest	171
Prepaid Rent	181

	<u>Account No.</u>
Property and Equipment (201-250)	
Land	201
Buildings	211
Buildings — Allowance for Depreciation	212
Automobiles and Trucks	216
Automobiles and Trucks — Allowance for Depreciation	217
Furniture and Office Equipment	221
Furniture and Office Equipment — Allowance for Depreciation	222
Machinery	226
Machinery — Allowance for Depreciation	227
Tools	231
Tools — Allowance for Depreciation	232
Leasehold Improvements (Rented Property Improvements)	246
Leasehold Improvements — Allowance for Amortization	247
Miscellaneous Assets (251-300)	
Organization Expenses (Business Starting Costs)	251
Deposits (Advance Payments)	261

LIABILITIES (301-450)

Notes and Amounts Payable to Others (301-350)	
Notes Payable — Short Term	301
Accounts Payable (Bills Payable)	311
Sales Taxes Payable	321
FICA Tax Withheld	331
Federal Income Taxes Withheld	332
State Income Taxes Withheld	333
Expenses Owed to Others (351-400)	
Accrued Wages (Wages Owed)	351
Accrued Commissions (Commissions Owed)	356
Accrued Interest (Interest Owed)	361
Accrued Federal Unemployment Taxes (Fed. Unemployment Taxes Owed)	371
Accrued State Unemployment Taxes (State Unemployment Taxes Owed)	372
Accrued Real Estate Taxes (Real Estate Taxes Owed)	381
Accrued Federal Income Taxes (Federal Income Taxes Owed)	391
Accrued State Income Taxes (State Income Taxes Owed)	392
Long-Term Obligations (401-450)	
Notes Payable — Long-Term	401
Mortgages Payable	411

OWNERSHIP EQUITY (451-500)

*Capital Investment (Investment in Business)	451
**Capital Stock (Stock Issued)	461
*Drawings (Cash Used Personally)	481
Retained Earnings (Profit Not Spent)	491

*For use only by sole owners or partners

**For use only by corporations

PROFIT OR LOSS STATEMENT (Accounts 501-999)

Sales and Other Income (501-550)	
Sales of Merchandise	501
Sales Returns and Allowances	502
Cash Discounts Allowed (Discounts to Customers)	503
Service Charges	511
Rental Income	521
Cash Discounts Taken (Discounts from Suppliers)	531
Miscellaneous Income	541
Cost of Goods Sold (551-600)	
Cost of Merchandise Sold	551
Freight on Purchases	561
Cost of Business Operations (601-700)	
Wages	601
Labor From Agencies	602
Supplies	611
Tools	612
Rental of Equipment	621
Repairs to Equipment and Machinery	631
Repairs to Trucks	632
Truck Maintenance (Gas and Oil for Trucks)	641
Selling Expenses (701-750)	
Advertising	701
Automobile Expenses — Sales Force	711
Commissions	721
Entertainment Expenses	731
Travel Expenses	741
Administrative Expenses (General Expenses) (751-800)	
Salaries	751
Office Supplies	761
Postage	762
Telephones	763
Dues and Subscriptions	764
Insurance — Miscellaneous	771
Group Insurance	772
Workmen's Compensation Insurance	773
Automobile Expense	781
Professional Services	786
Bad Debts	791
Interest	796
Miscellaneous Expenses (801-850)	
Building Expenses (851-900)	
Rent	851
Repairs to Building	861
Utilities	871

	<u>Account No.</u>
Depreciation (901-950)	
Depreciation — Buildings	911
Depreciation — Automobiles	916
Depreciation — Furniture and Office Equipment	921
Depreciation — Machinery	926
Depreciation — Tools	931
Amortization — Rented Property Improvements	946
Taxes (951-999)	
FICA Taxes	951
Unemployment Taxes	952
Real Estate Taxes	961
Miscellaneous Taxes	962
Federal Income Taxes	991
State Income Taxes	992

Section 4

Business Statements

Contents

Purposes of Business Statements	<i>Page</i> 87
The Basic Business Statements	87
Preparing the Business Statements	88

Business Statements

Purposes of Business Statements

Business statements are written reports which describe the condition of the business. Some of the purposes of business statements are to determine answers to questions such as these:

- How profitable is the business?
- Which costs appear to be a problem?
- What is the makeup of business assets?
- How much is owed on debts of various kinds?
- How much is the owner's investment?
- What significant changes have occurred between years (or months)?

The Basic Business Statements

There are basically three important business statements or reports:

1. *Statement of Earnings* shows the sources of income, the costs and expenses of running the business, and what is left over for profit.

2. *Balance Sheet* shows information at a specific date such as at the end of a month or months or at the end of a year. It summarizes what the business *owns*, grouped into different kinds of assets. Similarly, it summarizes what the business *owes*, grouped into different kinds of liabilities. It is completed by showing the owner's investment in the business and the amount by which that investment has been increased from profits kept in the business or decreased by losses or withdrawals.

3. *Statement of Changes in Financial Position* summarizes the financing and investing activities of the business, including the sources from which cash or other current assets were obtained and how they were used. For example, the sources of funds might be from operations, borrowings, or additional investment. The uses of funds might be to increase equipment or decrease borrowings. This report is most often used by banks in making loan decisions.

Another statement considered basic for a larger business is the *Statement of Retained Earnings*, which summarizes the net income earned, any portion taken out or distributed, the balance retained for business use, and the accumulated income that has been left in the business. Various other supplementary schedules may also be prepared to show in greater detail some of the principal elements of the Statement of Earnings and the Balance Sheet.

Preparing the Business Statements

The proper preparation of business statements generally requires a person with some experience. Perhaps an accountant may be needed where matters are more complicated. It may be possible to hire someone on a part-time basis for smaller businesses.

Before preparing business statements, it is necessary that the following work be completed:

1. All transactions must be recorded in the journals.
2. The postings from the journals must be made to the ledger.
3. The trial balance must be prepared.

This procedure was explained in Section 2 and illustrated in that section for the case of George New and his lumber business. It is suggested that you review it before examining the sample financial statements in this section. In the case of the ABC Company, it was assumed that the adjustments for things such as depreciation, prepaid expenses, and similar items were made before the trial balance was prepared so that no further adjustments were necessary.

From the completed trial balance work sheet, the Statement of Earnings and the Balance Sheet that follow can be prepared easily by copying from the last four columns. The Statement of Changes in Financial Position can be prepared by comparing the company's present balance sheet with its previous balance sheet (not shown).

Samples of business statements follow (pp. 89–92).

ABC Company
Trial Balance Work Sheet
Six months ended January 31, 19XX

Acct. No.		Trial Balance		Adjustments		Statement of Earnings		Balance Sheet	
		Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
21	Cash in bank	\$ 4,000						\$ 4,000	
61	Accounts receivable — customers	12,000						12,000	
101	Inventory — goods for sale	18,000						18,000	
181	Prepaid rent	500						500	
216	Automobiles and trucks	4,200						4,200	
217	Autos and trucks — allowance for deprec.		\$ 2,100					(2,100)	
311	Accounts payable		7,000						\$ 7,000
351	Accrued wages		2,600						2,600
401	Notes payable — long-term		3,000						3,000
451	Capital investment		5,000						5,000
491	Retained earnings		5,280						5,280
501	Sales of merchandise		108,000				\$108,000		
502	Sales returns	1,000					(1,000)		
551	Cost of merchandise sold	51,700				\$ 51,700			
601	Wages	10,000				10,000			
611	Supplies	6,200				6,200			
721	Commissions	4,000				4,000			
751	Salaries	11,700				11,700			
761	Office supplies	300				300			
791	Bad debts	1,200				1,200			
796	Interest	300				300			
851	Rent	6,000				6,000			
916	Depreciation — autos and trucks	1,000				1,000			
951	FICA taxes	880				880			
	Net earnings					13,720			
		<u>\$132,980</u>	<u>\$132,980</u>			<u>\$107,000</u>	<u>\$107,000</u>	<u>\$36,600</u>	<u>\$36,600</u>
									<u>13,720</u>
									<u>\$36,600</u>

ABC Company

Balance Sheet

Six Months Ended January 31, 19XX

ASSETS

Current Assets

Cash in bank	\$ 4,000	
Accounts receivable — customers	12,000	
Inventory — goods for sale	18,000	
Prepaid rent	<u>500</u>	
		\$34,500

Property and Equipment

Automobiles and trucks	\$ 4,200	
Less depreciation	<u>2,100</u>	
		<u>2,100</u>
		<u>\$36,600</u>

LIABILITIES AND OWNER'S EQUITY

Current Liabilities

Accounts payable	\$ 7,000	
Accrued wages	<u>2,600</u>	
		\$ 9,600

Long-Term Liabilities — Notes Payable

3,000

Owner's Equity

Capital investment	\$ 5,000	
Retained earnings		
July 31, 19XX	\$ 5,280	
Net earnings before income taxes —		
Six months ended January 31, 19XX	<u>13,720</u>	
		<u>19,000</u>
		<u>24,000</u>
		<u>\$36,600</u>

ABC Company
Statement of Earnings

Six Months Ended January 31, 19XX

Income			
Sales of merchandise	\$108,000		
Less — Sales returns	<u>1,000</u>		
Net sales		\$107,000	
Cost of Merchandise Sold		<u>51,700</u>	
Gross Profit on Sales			\$55,300
 Operating Expenses			
Cost of business operations			
Wages	\$ 10,000		
Supplies	<u>6,200</u>		
		\$ 16,200	
Selling expenses — commissions		4,000	
Administrative expenses			
Salaries	\$ 11,700		
Office supplies	300		
Bad debts	1,200		
Interest	<u>300</u>		
		13,500	
Building expenses — rent		6,000	
Depreciation — autos and trucks		1,000	
Taxes — FICA		<u>880</u>	
			<u>41,580</u>
Net Earnings Before Income Taxes			<u><u>\$13,720</u></u>

ABC Company
Statement of Changes in Financial Position

Six Months Ended January 31, 19XX

Source of Funds	
From operations	\$13,720
Add income charges not requiring the use of funds	
Depreciation — autos and trucks	<u>1,000</u>
	14,720
Use of Funds	
Decrease long-term borrowings	<u>(500)</u>
	<u><u>\$14,220</u></u>

Section 5

Business Taxes

Contents

	<i>Page</i>
Payroll Taxes	95
Federal Social Security	95
Federal Unemployment	95
State Unemployment	96
Federal Income Tax Withholding From Employees	96
Federal Depository Payments of Withheld Income and Social Security Taxes	96
State Income Tax Withholding	96
 Sales Tax	 97
 Property Tax	 97
 Income Taxes	 97

Business Taxes

Taxes are an important concern in any business undertaking. To avoid penalties and interest charges, required returns must be filed and tax payments made when due. Any new business must obtain proper identification numbers in order to report taxes. An Employer Identification Number is used in reporting all federal taxes; it may be obtained by completing Federal Form SS-4. State identification numbers vary with the type of tax; apply to the taxing body for your state number.

Businesses are generally subject to four types of taxes: *payroll*, *sales*, *property*, and *income*. Each of these will be discussed in turn.

Payroll Taxes

When a business pays a salary to even one employee, it becomes subject to payroll taxes. If the business is a corporation, even the "owner" is an employee. An employer is responsible both for the taxes withheld from an employee (for example, federal and state income taxes) and for taxes assessed directly (for example, social security and unemployment). Payroll taxes must be deposited by dates that vary according to the amount of taxes payable. The following paragraphs summarize the requirements in effect in 1984. These are subject to change.

Federal Social Security

For 1984, the tax rate is 7 percent for an employer and 6.7 percent for an employee, or a total of 13.7 percent on wages up to \$37,800 per year for each employee. In 1985, the rate will be 7.05 percent on each. In 1986 and 1987 it will be 7.15 percent and in 1988, 7.51 percent. The maximum social security to be withheld in 1984 is \$2,646 per employee per year. An equal amount is payable by the employer.

Self-employed persons pay 11.3 percent on a maximum net earned amount of \$37,800. This maximum tax is \$4,271.

Federal Unemployment

Annual wages up to \$7,000 per employee are subject to this tax at an effective rate of 0.8 percent. An employer is generally either one who employs one or more persons in each of twenty days in a year, each day being in a different week, or one who has a payroll of at least \$1,500 in a calendar quarter (for example, January, February, and March).

This tax is payable by the end of the month following each of the first three calendar quarters (for example, on April 30 for the quarter made up of January, February, and March). Each payment is made to a depositary (authorized financial institution or a Federal Reserve

bank) accompanied by coupon from a Tax Deposit Coupon Book (Form 8109). Quarterly returns are not required. Instead, a report, Form 940, must be filed for the whole year and is due by January 31 of the next year. Any balance of tax due for the year must be paid in January (using a coupon).

The quarterly payments previously described are not required if the tax for that quarter plus the tax not deposited for prior quarters in the calendar year is \$100 or less. For example, if the computed tax for the quarter ended March 31 was \$90, no depositary payment would be required for that. Then, if the tax for the quarter ended June 30 was \$240, there would be a depositary payment of \$330 to be made by July 31.

State Unemployment

All states (plus the District of Columbia and Puerto Rico) have unemployment taxes with the wage base set the same as the federal maximum of \$7,000 per employee. State tax rates are usually based on "experience" and will vary from employer to employer.

Federal Income Tax Withholding From Employees

Withholding tables are available from which to determine the amount to be withheld based on the employee's compensation for each pay period and the number of exemptions claimed by him or her.

Federal Depositary Payments of Withheld Income and Social Security Taxes

The time of payment is summarized below for income tax withheld from employees, social security tax withheld, plus the employer's share of social security tax. Deposits should be made to an authorized financial institution or a Federal Reserve bank accompanied by a Federal Tax Deposit Coupon (Form 8109).

1. If the amount of these taxes is less than \$500 for a calendar *quarter*, the employer is not required to make deposits by the last day of the month after the quarter. The payment can instead be made directly to the Internal Revenue Service with quarterly tax returns, which are due by the last day of the month after the quarter.
2. If the amount of tax is at least \$500 at the end of any month but less than \$3,000 at the end of any eighth monthly period, depositary payments must be made by the 15th day of the month after the \$500 is reached. Final payment for a quarter is made to the depositary by the last day of the month after the quarter.
3. Earlier deposit payments are required if the tax is \$3,000 or more at the end of any eighth monthly period. (Details of this requirement are not considered to be of sufficient interest to discuss here, and should be obtained by anyone to whom the requirement would apply.)

State Income Tax Withholding

Each state has its own requirements for depositing state income tax withheld from employees. Tables are available to determine the amount to be withheld from each employee.

Sales Tax

Sales taxes are levied by state and local authorities and apply to businesses that sell to final consumers. Even if sales to final consumers are only a small percentage of total sales, you are required to collect and report taxes on such sales. Generally, sales taxes are due by the last day of the following month. Rates, of course, vary among the taxing bodies.

Property Tax

If a business owns real estate, it must pay real estate taxes. If a business leases its premises, its lease might call for payment of real estate taxes, or the amount of any increase in real estate taxes, as additional rent. Real estate taxes are generally due in several installments during the year.

A business may be taxed on its personal property, and a corporation, additionally, on its capital stock. Both of these latter taxes require the filing of a tax return. These returns should be discussed with a CPA before completion.

Income Taxes

The federal government and most states and many cities collect taxes based on income. It is, of course, not possible to generalize about them.

Income taxes levied on a business depend on the form in which the business is conducted. Generally, a sole owner or a member of a partnership will report the net income from the business in an individual income tax return. A partnership files a separate information return from which the taxable amounts are reported by each partner on the individual return. A sole owner reports the various items of income and expense directly in the individual return. Small business corporations that are Subchapter S corporations also file a separate information return and, like a partnership, pass through income to shareholders. The income as reported is taxed by the federal government at individual rates that vary with the amount of income.

Other corporations pay taxes based on net income. Dividends paid to shareholders out of such earnings are taxed again to shareholders when received. Federal corporate tax rates for corporations with taxable income not in excess of \$1,000,000 are: 15 percent on the first \$25,000, 18 percent on the second \$25,000, 30 percent on the third \$25,000, 40 percent on the fourth, and 46 percent on the remainder. These are subject to change.

Depending on the nature of the business, other taxes and licenses may be required by federal, state, and local taxing authorities.

Federal and many state income taxes are payable in advance based on estimates of tax. For those whose year ends on December 31, the estimated payments are due April 15, June 15, September 15, and January 15. The tax return and any balance of tax remaining is due on March 15 of the following year for corporations and April 15 for all other taxpayers. For those whose year ends in a month other than December, the due dates vary correspondingly.

Section 6

Using Outside Help

Contents

	<i>Page</i>
Bookkeepers	101
Certified Public Accountants	101
Attorneys	102
Form of Organization	102
Dealing With Others	102
Personal Planning	103
Technical Assistance Programs	103
Bankers	104
Minority Business Development Agency	105
The Small Business Administration	105
Insurance Advisers	105

Using Outside Help

Bookkeepers

Proper accounting information is important in planning, organizing, and controlling a business. It helps provide answers to the basic questions, “How am I doing?” and “Where am I going?” In previous sections of BIG it was pointed out that there are times and conditions when outside help in this area may be needed. This will depend in part on the size and nature of the business and your own experience and available time. Your accountant, attorney, or banker can help you decide your needs for a bookkeeper (part- or full-time) or for a bookkeeping service.

It is important that someone perform the following.

1. Start and keep an accounting system for the accurate and timely recording of your company’s cash receipts, disbursements, sales, and operating expenses.
2. Periodically prepare the following:
 - Statement of assets and liabilities as of a given date (commonly referred to as a *balance sheet*)
 - Statement of results of operations for a given period of time (commonly referred to as an *income statement*)
 - Statement of changes in financial position
 - Listings of customers owing you money as of a given date and to whom you owe money
 - Such other financial information as may be needed
3. Prepare state and federal income tax returns.
4. Prepare social security, withholding, personal property, and other tax returns.

Certified Public Accountants

In addition to bookkeeping requirements, you may need the services of a certified public accountant (CPA). A CPA is an accountant who has passed a written examination prepared by the American Institute of Certified Public Accountants and who has received a state license for the public practice of accountancy. CPAs provide the following services.

- *Auditing.* Although you may have hired your own bookkeeper to maintain your accounting records and prepare financial statements, there are many reasons why you may need

financial statements certified by a CPA. For example, banks and other lenders frequently require that you have an audit before a loan is granted and during the period that the loan is outstanding.

- *Taxes.* Most businesses do not have employees who are experts in tax matters and therefore must rely on professional assistance. This is particularly true today when the tax laws are complex and continually changing. The tax services provided by CPAs include planning transactions for the lowest present and future tax liabilities, preparation of tax returns, conferences with taxing authorities who are examining prior years' tax returns, and estate planning.
- *Consulting.* Because of their experience with many companies in many industries, CPAs may be able to assist you in cost reduction, improvement of reports, installing or upgrading accounting systems, budgeting and forecasts, financial analysis, production control, quality control, compensation of personnel, and records management.

In addition to the services above, a CPA may also perform special studies and investigations of suspected fraud.

Attorneys

Trying to operate a small business without assistance from attorneys can be an expensive economy. Problems that often require attorneys can be grouped into two major areas: starting a new business and operating a going business.

Whether the small business is to be operated by one individual or by several, the problems connected with starting up are generally similar.

Form of Organization

The individual or individuals planning to start a business may need assistance in deciding whether to operate as a sole proprietorship, general or limited partnership, or corporation. There are differences in personal liability for business debts, in income tax effect, and in other respects that need to be clearly understood.

Dealing With Others

The small business may need professional help in dealing with other parties.

- *Financial institutions.* The typical small business may have to borrow much of its initial capital from a bank under the Small Business Administration loan-guarantee program. In addition, there may be Minority Enterprise Small Business Investment Companies (MESBICs) serving the community who may be interested in investing in the business. If so, many documents must be prepared.
- *Owners of possible store or plant locations.* Should the new business rent or purchase? What does the "fine print" in the typical lease or sale contract mean?
- *Union officials.* In many industries or lines of business, the employer will have no choice but to accept a union shop. In other cases, however, the employer faces difficult decisions. Whether or not the employer accepts the union, help will be needed in negotiating agreements necessary between employer and employee.
- *Governmental bodies.* The small business may be eligible for grants, loans, loan guarantees, and favorable treatment in bidding for service or supply contracts let by govern-

mental agencies. The lawyer may be able to help in locating the source of such assistance and in preparing any necessary documents.

Some form of law or regulation affects nearly every business, although some may be more affected than others.

For example, it is illegal in most states for a truck owner to operate a truck for hire without some form of permit or certificate. On another level, every business faces zoning problems, and almost every business must obtain necessary licenses and permits governing various health, liquor, or dangerous occupations. If a business name other than the owner's is used, it may be necessary to file a form with a governmental agency, such as the County Recorder. The trade name or trademark proposed to be used may conflict with trade names or trademarks held by others; in any event, registration may be advisable to protect a desired trademark or trade name. "Truth-in-lending" laws may apply to a retailer's credit operation. And, finally, federal economic controls may apply, both to prices and to wages.

- *With franchising companies.* Under certain conditions, operating a franchise may reduce some of the risks and problems faced by a new business. But it has many of its own risks for which advice of an attorney is needed.
- *Others.* In addition to the parties listed above, it may be necessary to enter into long-term agreements with suppliers, customers, or employees, or to negotiate insurance coverage, or have other relationships for which legal advice may be needed.

In operating a going business, whether an existing business was purchased or a new one was started, there will be many of the problems discussed above. In addition, other problems will arise, which probably will involve the attorney.

- The employer may be served with wage deduction orders against employees, which, if not handled properly, can result in personal liability on the part of the employer.
- The business may face collection problems with its customers.
- The business may become involved in disputes with its trade creditors.
- The business may have disputes with both present and former employees.
- Expansion opportunities may present themselves and questions similar to those which arise in starting a business may need to be considered.

Personal Planning

The above discussions dealt with your problems in starting and operating the business. In addition, there may be a need to revise your financial and estate planning in view of the risks and opportunities presented by the business. Advice may be needed for protecting your family's financial security from the business risks.

Technical Assistance Programs

In the larger urban areas, such as New York, Chicago, Los Angeles, Boston, and Philadelphia, various organizations (for example, state societies of certified public accountants) maintain programs to provide technical assistance to qualifying businesses.

The American Institute of Certified Public Accountants, located in New York, knows of similar activities in many other cities. The local affiliate of the Office of Minority Business Enterprise may also be able to assist you.

Bankers

The modern commercial bank offers a wide range of services for its customers and can be very helpful to you. In addition to offering many other services, it (1) accepts money for safeguarding in the form of deposits and (2) supplies capital in the form of loans.

You become a depositor in a bank by opening an account there. While banks solicit new accounts, they are particular, to a degree, about the persons or firms approached. Being in business themselves to make profits, they prefer as depositors those who will maintain balances in their accounts and who will bring profitable loans to the banks. The bank may require you to maintain a minimum balance in your checking account. Your banker will assist you in determining the types and number of checking accounts (and savings accounts) your company should have.

Bank loans are advances of money by banks in exchange for an agreement to repay the bank at some future time with an agreed rate of interest. Loans may be either secured or unsecured. Unsecured loans are normally made to well-known customers in amounts within the customer's ability to repay. A loan is secured when the borrower gives the bank a right to claim title to valuable property (*collateral*). The bank can sell this collateral and use the proceeds as payment for the loan should the borrower be unable to pay. The banker will normally request that the market value of the collateral be considerably in excess of the loan balance. The length of time for which banks make loans ranges from loans payable on demand, to term and mortgage loans running for a number of years. The period involved is determined by the proposed use of the money. Since interest must be paid, it is important that the money be put to profitable use. From the use of the borrowed funds, you should earn enough to cover interest and a margin of profit for yourself. Loans made by banks must, of course, be repaid. The method of repayment is shown in the loan agreement. The interest payments may be at one or more times during a year or at the due date of the loan. Similarly, the principal may be payable on an installment basis or in full on a specific due date.

The nature of the banking business is such that it lends itself readily to other services. The following are some of the other services offered by banks.

- *Business advice.* It is frequently said that the banker should be business guide and friend to his clients. Bank officers develop a broad understanding of the operations of their clients. Some banks employ engineering and management experts who are made available to their clients for suggestions and guidance. It is very important that you find a banker who is interested in you and your company. You should consult with him or her regularly and ask advice on the more important decisions affecting the business's future.
- *Credit advice.* Every sizable bank has a credit department that handles credit problems that arise daily. A bank with a good credit department can frequently be helpful to you.
- *Agency services.* Though it may act as agent in many important and complex ways, the bank's use as an agent for collection and disbursement services of various kinds should be of most interest to smaller businesses.
- *Trust services.* Most banks have trust departments that, among other things, handle financial affairs for people who want them to manage investments or hold them and to collect income and pay it out as agreed. Some buy this service while living; others name the bank as executor in a will to take charge when the individual dies.
- *Safe deposit boxes.* Many banks provide safe-deposit-box services. The boxes are of different sizes and are charged for accordingly. The service is a simple one but is frequently used for the safekeeping of various corporate records.

Minority Business Development Agency

The Minority Business Development Agency (MBDA), created in 1979 under the Department of Commerce, provides management and technical assistance and encourages financial support for minority business owners. Its predecessor, the Office of Minority Business Enterprise (OMBE), had been created in 1969 by presidential executive order. The 1979 restructuring was designed to help minority businesses develop into medium- and large-sized firms in growth industries that produce jobs, add stability to communities, and improve the overall economy.

The MBDA has six regional offices located in New York City, Washington, D.C., Atlanta, Chicago, Dallas, and San Francisco, and smaller district offices in thirty-three other cities. The regional offices manage a network of 100 local business development centers. By visiting one of these centers, the minority entrepreneur can get assistance in preparing a business loan package, securing sales, or solving a particular management problem.

For further information on the services available through MBDA, contact the local affiliate or district office or write directly to:

Minority Business Development Agency
U.S. Department of Commerce
Washington, D.C. 20230

The Small Business Administration

The Small Business Administration (SBA) is an independent government agency created by Congress in 1953 to help small businesses grow and prosper. The SBA has offices in a large number of cities throughout the country. SBA offers small businesses financial assistance, including loan guarantees, management assistance, aid in obtaining government contracts, counseling services, and more than 800 publications. In addition, the SBA is responsible for the Small Business Investment Company (SBIC) program. Small Business Investment Companies provide capital, chiefly in the form of long-term loans or part ownership financing, to small business concerns. You should contact the nearest SBA office to find out more about the various types of financial assistance being offered by the SBA.

Insurance Advisers

If you cannot afford insurance, you cannot afford to be in business. You can have too little or too much, but you must have insurance. It is therefore necessary to have the assistance of a good insurance adviser who can tell you what type you should have, how much, and see that you don't overpay. A meeting with your insurance agent should not take place less than annually.

There are four basic kinds of insurance.

1. *Property.* Property insurance covers your property from various types of losses such as fire and theft. Protection can also be obtained for windstorm, hail, riots, explosions, and so forth. This is known as extended coverage. Property includes such things as buildings, machines, furniture, inventory, and so forth.
2. *Liability.* Liability insurance covers you against losses caused by your own carelessness or negligence. Even though you are careful, under the law you may not have been as careful as you should have been. The amount of a damage claim can be huge. Setting proper limits of coverage for this type of insurance is very important and should be discussed with your insurance agent.

3. *Motor vehicle.* Motor vehicle insurance is very important insurance and usually includes a combination of one and two above. There are many kinds of policies, such as those for owned and non-owned vehicles or automobiles. There is also a wide variation in the rates or costs, depending upon things like “deductibles” or how much the insurance company deducts before they begin to pay claims. Again, a good insurance broker is a big help.
4. *Special types.* Certain kinds of insurance are offered to cover you for particular things such as—
 - Workmen’s compensation, which is required by law in most states to protect you and your employees against injuries that happen while at work.
 - Life insurance, in case of death.
 - Health or medical insurance, which pays hospital and doctor bills.
 - Disability insurance, which pays you a salary while you are disabled.
 - Business interruption, which can pay for expenses and the loss of profits if your business is interrupted.

There are fairly new developments in the insurance field. An example of this is a “comprehensive” or “package” policy. This has all your insurance needs written into one or two policies instead of many policies for different kinds of coverage. The cost is usually less than when it is bought separately. There are also “umbrella” policies that provide added coverage at a lesser rate for amounts in excess of the first policy.

Insurance should be purchased before you start in business. It is not something you “wait until later” to buy. Insurance people are usually happy to discuss your needs with you and seldom charge for their advice. Their profit is made if and when you decide to purchase an insurance policy from them.

If you do not know a good insurance agent, one of your other professional advisers can possibly assist you in finding one.

Section 7

Computers for Small Businesses

Contents

	<i>Page</i>
Does Your Business Need a Small Computer?	109
How to Select a Computer	110
Software	110
Hardware	111
Narrowing the Field	112
Leasing, Buying, or Using a Service Bureau	113
Conclusion	113
Computer Terminology	113

Computers for Small Businesses

With the cost of small computers dropping and the almost daily introduction of new models, the decision to purchase a computer for your business may indeed seem overwhelming. This section is designed (1) to help you determine if your business needs a computer, and (2) to make you aware of the significant factors to consider when selecting a computer system.

Does Your Business Need a Small Computer?

To determine whether you may benefit from the purchase of a small computer, you should perform a thorough written review of your business's operations. Such a review helps you make an intelligent decision about your needs so you can select the computer most appropriate to meet them. Karl G. King and Mark L. Hildebrand identify these five review considerations in their article "How to Help a Client Select a Data Processing System" (*The Practical Accountant*, May 1983).

1. *Problem areas.* What are the problem areas in your business? Describe how these are currently handled. Your mailing lists constantly require updating, for instance, and the task must be performed manually.
2. *Automation.* How do you know which tasks lend themselves to automation? "Yes" answers to the following questions are good indicators that a small computer may be beneficial to your business:
 - Does your business have high clerical costs?
 - Are there many high-volume, time-consuming, repetitive operations in your business?
 - Are complex mathematical or logical techniques used in your business? Is there a high degree of accuracy required for these techniques?
 - Is there a need for summary information that has to be taken from more than a few files?
 - Are more prompt and more accurate reports needed?
 - Is there a short response time for decision making in your business?
3. *Volume of business activity.* Does your business have a sufficient volume of sales to warrant automation? Recognizing that you have some automation needs (which most businesses do) is not enough; your business should have significant quantities of such transactions to justify the cost of a computer. To examine the volume of accounts receivable in your business, complete the questionnaire in exhibit A on page 115. The first four columns of the questionnaire give information on your business's historical and current volume of accounts receivable and related information. For planning purposes, fill in the final column that shows your expectations for growth of accounts receivable. If you expect a growth rate of more than 20 percent per year, you will probably need to hire additional personnel at some point or consider the purchase of a computer to assist in the processing of accounts receivable.

4. *Savings.* How much will your business save if you purchase a computer? Examples of areas where savings may be accrued from the purchase of a computer are a reduction in secretarial overtime expense or the elimination of the use of a service bureau. Keep in mind, however, that the greatest advantage in buying a small computer is that you will be able to produce more accurate and timely information for business decision making.
5. *Computer cost.* What is the maximum amount you are willing to spend on a computer? To determine the total cost of a computer you must include: the computer itself, software, costs for maintaining the computer's physical security, personnel training costs, back-up contingencies for breakdowns, insurance coverage, and extended service contracts. It is also important to anticipate future data processing needs in your business. Will your business be expanding in the short term? If so, you may need to purchase additional software and memory capability for the computer in the near future. Determining these costs, however, is difficult without speaking to a computer vendor.

How to Select a Computer

Once you have reached the decision that a computer will be beneficial to the success of your business, read literature on the topic and find out what types of computers business associates are using in their businesses—then ask if they are satisfied. Also inquire about the quality of service from their vendors after the sale. The expense of owning a system without local vendor support may quickly offset any initial savings. Contact several computer vendors and compare each computer's features and each vendor's support system. As a basis for discussion with vendors, compile a list of all the functions you want a computer to perform. Exhibit B on page 116 is a partial list, by category, of various uses for a computer. Consider attending a "user group" session; many vendors have such sessions for initial buyers.

Once you have done your computer homework, you should be ready to talk to vendors about specific computers. Your discussions with each vendor should give you in-depth knowledge about both the software and hardware of a computer system.

Software

This is the term for the instructions that command a computer to perform specific tasks. Software is written in a variety of computer languages. To use today's business computers it is not necessary to fully understand the intricacies of software languages or know how to write a computer program. A variety of prepackaged software programs can be purchased to run on most computers on the market. However, it is important to understand which computer software programs can be run on a given computer.

Numerous "application programs" have greatly simplified many routine business activities. For instance, available software for the accounting functions of general ledger, accounts receivable, and accounts payable perform these functions quickly and efficiently. By the use of "spreadsheet" programs in financial planning, you can use the "what if" approach to test alternatives, such as comparing mortgages having different interest rates over several years of payments.

The most important part of selecting a computer is to discuss with the vendor the pre-packaged software programs available for your business needs. Take along the list of problems your business is experiencing. A good vendor should be able to match those needs with specific software programs. But make sure that this software does what it claims to do by asking the vendor to demonstrate its capabilities. Read the documentation, or user instructions, to determine if it is clear and comprehensive.

Hardware

After you have selected your software, the vendor should be able to advise you on the compatible hardware to run it. Hardware is defined as the physical component of the computer system. It usually consists of a central processing unit (CPU) that performs arithmetic, logic, and control operations and a number of connected devices to retrieve, print, store or transmit data. Not every CPU can run every program; software is written for particular CPUs.

By narrowing the field of prospective computer hardware, you may find it helpful to consider the following features in discussions with vendors.

Memory capacity. The central processing unit contains a memory capacity that is defined in terms of "bits and bytes." A bit is the smallest unit of information that can be manipulated by a computer. Computer memories are most commonly structured in units of "bytes," or collections of 8 bits of information. It is important to discuss with a vendor the maximum amount of bytes that a computer can manipulate to determine if it has the capacity to handle your software. Computer memory is most often referred to in thousands of bytes (kilobytes, or K) — 32K, 64K, 128K, 256K, and so forth.

In discussing the memory capacity of a given computer, inquire about *how* information is stored in the computer. Business computer memory comes in the form of hard or floppy disks. A hard disk is a rotating metal magnetic platter similar to a phonograph record that can store a lot of information. It is generally quite a bit more expensive than a floppy disk. A floppy disk, or diskette, is a single platter of magnetic film or plastic contained in a small cardboard package. Floppy disks are far less expensive than hard disks but they do not last as long or hold as much data.

In summary, you need to discuss with each vendor: (1) the amount of memory storage necessary, and (2) what type of storage device (hard vs. floppy disk) is best for you.

Video Display Terminal (VDT). The VDT or monitor is a device with a video screen for data viewing by the computer user. The VDT consists, in part, of a cathode ray tube (CRT) that provides visual images of the data being manipulated by the computer user. The VDT is the computer user's "window" on the operation of the computer program.

VDTs are made in a variety of sizes and styles. Screen sizes run anywhere from a few inches to twelve inches in width. You should experiment using different VDT sizes to see which is most suitable to you and those who will be using the computer on a regular basis.

VDTs are made so that screen images come in both solid color and a variety of color-on-black combinations. Color-on-black VDTs are produced in amber, green, and white. While color VDTs are preferable for reducing eyestrain, they are generally more expensive.

Keyboard. The keyboard on a computer is similar to that of a typewriter, but there are usually more keys for special functions that control the processes of the computer. Many keyboards also possess a "numberpad" similar to an adding machine keyboard. It provides for quick manipulation of numbers. You should feel comfortable using the keyboard, both from the standpoint of touch and ease of function.

Printer. If you decide to purchase a printer for your computer (they are generally priced separately), you should know the three most popular types of printers: dot-matrix, daisy wheel, and ink jet. Each name refers to the printing mechanism in the printer. Printers can cost as little as \$300 or as much as \$3,000. Dot-matrix printers generally print copy faster and tend to be less expensive, but they do not produce letter-quality copy. In contrast, daisy-wheel printers produce fully formed characters for letter-quality copy but are usually more expensive and slower. The third type of printer is the ink-jet printer, which blows small streams of ink to make its characters. The ink-jet printer is quieter than the dot-matrix and daisy-wheel printers, and it can produce color images. A final alternative, if you own an IBM Selectric, is to buy an interface with your computer so the Selectric can operate as a printer. Ultimately, you need to decide if one type of printer is preferable or if a combination of printers is needed.

Ask the vendor about the speed of the printers you are considering. Printers range in speed from less than a dozen characters per second to many lines per minute. Keep in mind that the printer can often be the slowest device in the computer system; if you purchase too slow a printer, you may be impeding the productivity of the entire system.

Graphics. If the ability to create graphics (which can be as simple as bar charts or as elaborate as blueprints) is important to you, ask the vendor about the graphics capability of both the computer and any printer you are considering. Some printers cannot perform graphics, and others need particular adapters or additional boards to go inside the computer. Some may need special software.

Compatibility. Be sure to ask the vendor about the compatibility of any additional hardware items (like modems, which allow your computer to get data transmitted over the telephone) with the computer you want to buy. Compatibility should never be assumed, even for products from the same vendor.

Narrowing the Field

Presumably, you have now visited several vendors and decided which systems will fit most of your business's needs. It is important here to review all of the pros and cons of each system under consideration. The *Datapro Directory of Small Computers* (published by Datapro Research Corporation of Deltran, N.J.) suggests that you ask each vendor that you are seriously considering to provide you with the following information.

- Detailed specifications and prices of all components, including hardware, software, expansion capabilities and limitations, as well as descriptions of compatibility with other hardware and software products.
- A detailed proposal outlining the technical support and training to be provided by the seller, warranty information, and an estimated timetable for delivery of the equipment. Will the vendor assemble the system and check for defects and damages, or will you have to assemble the system yourself?
- A test of the equipment.
- A reference list of users who have purchased similar systems and applications. These people may be able to share information and warn you of potential problems.

After you have received this information and have seen each prospective system in use, you should be able to choose the system that best fits your needs. No system will be perfect, but you should be satisfied overall with the system you select for your business.

Leasing, Buying, or Using a Service Bureau

But why buy at all? The *Datapro Directory of Small Computers* encourages business people to give some thought to leasing. An important consideration is the length of time that a particular system can handle your requirements. If the system has expansion capabilities, and it does not seem likely that your company will outgrow that system, it may be best to buy. However, if the system will not be able to manage operations beyond the next three years, you may be better off leasing data processing equipment.

Another alternative to consider is the use of a service bureau. Service bureau personnel provide a variety of data processing, bookkeeping, and payroll services for businesses at competitive rates. A service bureau may be an interim answer while you consider the purchase of a computer.

Conclusion

At some point many business owners will consider obtaining a small computer. This decision must be a careful one. The system you finally purchase should serve your particular business situation in a cost-effective manner if it is to be truly worthwhile to you.

Computer Terminology

Basic. Popular computer language invented for educational purposes. An acronym for Beginner's All-Purpose Symbolic Instruction Code.

Bit. Contraction of "Binary Digit." An electric signal or piece of data, or a number viewed as having exactly two states that might be: *on or off, one or zero, yes or no*. Bits are used in electronic systems to encode instructions and data. Bits are usually grouped in nybbles (four), bytes (eight), or larger units.

Byte. A collection of eight bits or electronic signals that, when taken together, represent a piece of information or a machine-language program instruction.

Cathode ray tube (CRT). A display screen for presenting information and graphics.

Chip. A group of electronic circuits that can perform a large number of functions. These electronic circuits can be manufactured and put into a chip of silicon about one-quarter inch square. This is mounted onto a socket whose projecting pins fit into a receptacle on a printed circuit board.

Density. The closeness with which information is packed on a medium, particularly disks for memory storage. It is measured linearly in terms of bits per inch, and radially on the disk in terms of tracks per inch.

Disk. A flat, circular object that resembles a phonograph record. As a record "stores" music, a disk stores information. The disk is inserted into a disk drive that rotates at high speed. The drive writes new information onto the disk and reads any information that is already stored

there. There are two major types of disks found on microcomputers—flexible floppy disks (diskettes) and hard disks, which have a storage capacity ten to thirty times greater than floppy disks.

Disk drive. A device that reads, at a very high speed, the computerized data stored on magnetic media called disks.

File. A logical block of information designated by name and considered as a unit by a user. A file is physically divided into smaller records.

Language. Any unified, related set of commands or instructions that the computer can accept. Low-level languages are difficult to use, closely resembling the fundamental machine operations of the computer. High-level languages roughly resemble English, and interact with the lower level languages that command the machine operations.

Memory. The portion of the computer that holds the program and data the computer needs to solve a problem.

Microcomputer. A small but complete computer system, including CPU, memory, input/output (I/O) interfaces, and power supply.

Modem. Modulator-demodulator. A device that transforms a computer's electrical pulses into audible tones for transmission over a phone line to another computer. A modem also receives incoming tones and transforms them into electrical signals that can be processed and stored by the computer.

Monitor (or VDT). A display unit (like a TV screen) containing a CRT, video amplifiers, horizontal and vertical scanning, synchronization circuits, and a power supply.

Operating system. A program that controls a computer's internal functions rather than performing a specific task like word processing.

Software. A collection or group of programs designed to perform a specific function; or any program used to operate a computer.

Terminal. A device through which data is sent to and received from a computer, with a keyboard for input and a printer or video screen (CRT) for output.

Exhibit A

Volume Questionnaire for Accounts Receivable

	Historical Volume			Present Volume	Projected Annual Growth Rate (percent)
	19XX	19XY	Percent Growth Rate		
Accounts Receivable					
● Average number of credit customers	_____	_____	_____	_____	_____
● Average number of statements per month	_____	_____	_____	_____	_____
● Average number of days that open-item invoices are outstanding	_____	_____	_____	_____	_____
● Average daily dollar amount of cash receipts	_____	_____	_____	_____	_____
● Average monthly number of new credit customers	_____	_____	_____	_____	_____
● Average daily number of charge transactions	_____	_____	_____	_____	_____
● Average daily number of cash receipt transactions	_____	_____	_____	_____	_____

Adapted from the questionnaire developed by Karl G. King and Mark L. Hildebrand in "How to Help a Client Select a Data Processing System," *The Practical Accountant*, Vol. 16, No. 5 (May 1983), p. 10.

Exhibit B

Computer Uses in Business*

<u>Product Development</u>	<u>Manufacturing</u>	<u>Marketing</u>	<u>Finance</u>
Research and development	Planning	Order-entry forecasting	Payroll
Automated design	Inventory control	Sales analysis	Budgets
Drafting	Purchasing	Sales control	Cost accounting
Engineering scheduling	Receiving	Advertising and promotion	Accounts receivable
Project control	Materials ordering		Accounts payable
Scientific computing	Materials handling		Billing
Simulation	Production scheduling		Asset accounting
Product testing	Shipping		General accounting records
Materials handling	Plant and tooling		
Process control			

* "Data and Information Processing in Business," Datapro Research Corporation (November 1980), p. 2.

Section 8

Business Words

Contents

	<i>Page</i>
Asset	119
Bad Debt	119
Balance Sheet	119
Bankruptcy	120
Buildings	120
Cash	120
Corporate Seal	120
Corporation	120
Cost of Sales	120
Deposit Slip	121
Earnings Projection	121
Equipment	121
Income Statement	121
Income Taxes	121
Income Taxes Payable	121
Inventory	122
Invoice	122
Land	122
Landlord's Waiver	122
Liability	122
Net Income	123
Other Operating Costs	123
Owner's Equity	123
Partnership	123
Payables	123
Payment on Account	123
Petty Cash	123
Receivables	124
Receiving Report	124
References	124
Sale	124
Sales Discount	124
Signature Card	124
Sole Proprietorship	124
Trade-Style Registration	125
Vendor	125

Business Words

Some may be familiar with the business language used in BIG or understand the use as explained in each section. For those who may not be so sure, some of the business words are defined and explained. This brief “dictionary of business words” can also be used separately from BIG to obtain explanations for words. The terms are arranged in alphabetical order with brief definitions followed by additional comments or examples.

Asset. An asset is something owned by the business that is of use to the business.

Some assets are necessary so there is a place for people to work or to operate the business—land, buildings, equipment, trucks, and so forth. These kinds of assets are generally kept for a fairly long time and are not sold to make a profit for the company.

Other kinds of assets may be kept for only a short time. These may be sold to make a profit for the company, or used to buy other assets or to pay off operating costs of the business. Such items would include inventories, which are sold for profit, or cash, which is spent to buy other assets or pay for other costs. Receivables are considered an asset because they represent money owed to you. As soon as this debt is paid, you have more cash to use.

Bad Debt. A bad debt is a receivable amount that you cannot collect.

A receivable arises when you sell something but do not collect cash immediately. If the customer never pays you that amount, you no longer have a receivable and have lost that amount of money which you expected to receive.

Balance Sheet. A balance sheet is a report which shows, on any particular day, what assets you own, what liabilities you owe, and the amount of your investment in the business.

This kind of report is called a balance sheet because of the way it is written, the amounts on the left and right sides of the report are equal, or are “in balance,” as shown by this example:

<u>Assets</u>		<u>Liabilities and Owner's Equity</u>	
Cash	\$100	Accounts payable	\$100
Receivables	300	Notes payable	100
Fixed assets	200	Mortgage payable	<u>200</u>
			400
		Owner's equity	<u>200</u>
	<u>\$600</u>		<u>\$600</u>

Therefore, the total of the liabilities and investment in the business will always equal the total of the assets; also, to find the investment in the business, you would subtract the liabilities from the assets.

A balance sheet is also called a financial statement which shows the financial condition of the business on a particular day.

Bankruptcy. Bankruptcy is the legal settlement of the amounts owed by a person or organization partially or wholly unable to pay debts.

The purpose of bankruptcy laws is to distribute, through a court-appointed officer, the bankrupt's assets fairly among the creditors. In most instances the bankruptcy proceeding discharges the debtor from further liability for the amounts owed to others.

There are two basic types of bankruptcy: voluntary and involuntary. A voluntary bankruptcy may be declared by a person or organization by petitioning a federal district court and presenting financial statements showing financial status. An involuntary bankruptcy may be asserted by the creditors of the bankrupt once certain financial claims against the debtor are proven.

Buildings. Buildings include any factory, warehouse, office, store, or garage owned by the business.

Any structure used for the operation of the business or to hold inventory or equipment owned by the business is considered a building.

Such buildings may be on land owned by the business or may be on rented land. Also, the buildings themselves may be owned or rented. When owned, they will appear on the balance sheet; when rented they usually do not appear there, since only assets owned by the business appear on its balance sheet. Buildings are an asset.

Cash. Cash is money that may be in your pocket, in the cash register, or in the bank.

The cash in your pocket that belongs to the business should not be mixed with your personal cash. Also, except in certain cases, none of this cash should be spent to buy things for your business. The cash in the bank for your business usually will be in a checking account. This money can be spent only by writing a check. Except in certain cases, checks should be issued to buy all things for your business. Cash is an asset.

Corporate Seal. A corporate seal is a notation made on certain legal documents and agreements in which one of the parties is a corporation.

An officer of the corporation will sign the document and the seal of the corporation may also be added. Generally, the seal is a metal disk about the size of a half-dollar mounted on the face of a hand-stamping tool. The document requiring the seal is placed between the stamps of the tool and the impression is squeezed onto the paper.

Corporation. A corporation is one of the three basic forms of legal organization for your company. The other two basic forms are a sole proprietorship or a partnership.

In order to be a legal "company", it is necessary to file certain forms with the state to obtain Articles of Incorporation, and so forth. At least three persons are required to start the company as incorporators in this form of organization. A corporation sells shares of stock, which are certificates indicating ownership, to as many people as is desirable. They are called *shareholders*. The shareholders then elect a board of directors, who guide the company on an overall basis. The board of directors elects a president and other officers who run the company on a day-to-day basis.

Cost of Sales. Cost of sales represents the cost of the particular products or services that are sold by the business.

When the product sold is merely purchased from another company for this resale, the cost of sales is basically the price paid to the supplier. When the product is manufactured or assembled, the cost of sales includes the costs of the required parts in the product, labor required for manufacture or assembly, and other costs relating directly to the product.

If the business sells services, the cost of sales mainly includes the wages for the people who provide the services, plus certain other required costs that relate directly to the service. Cost of sales is subtracted from sales in finding net income.

Deposit Slip. A deposit slip is a form that is given to the bank along with the coins, currency, and checks you deposit.

The deposit slip merely provides a listing of the items and dollar amounts put into the bank. The bank keeps a copy for its records, and you keep one for your own.

Earnings Projection. An earnings projection is an estimate of how much money your business expects to earn in the future.

When completed, a statement of your earnings projection will look like an income statement. The difference is that an income statement reflects what has happened in the past, while a projection reflects what you expect will happen in the future. The projection may cover a month, a year, or several months or years.

Equipment. Equipment includes machinery, trucks, cars, tools, show cases, scales, two-wheeled hand trucks, lockers, air conditioning units, and other such items owned by the business.

Sometimes, pieces of equipment used for the same purpose are grouped together and called "delivery equipment," "factory equipment," "office equipment," and so forth. Equipment is an asset.

Income Statement. An income statement is a report that tells you how much money the business made or lost over a period of time. The period of time might be a day, a week, a month, or a year or more. Generally, such a report covers not less than a month nor more than a year.

The following is an example of the general way an income statement looks.

Sales	\$1,000
Cost of sales	<u>600</u>
	400
Other operating costs	<u>200</u>
	200
Income taxes	<u>100</u>
Net income	<u><u>\$ 100</u></u>

The net income figure does not mean there will be an increase in cash of that amount during the period covered by the statement. Some of the income may have gone into increased equipment, inventory, and so forth, or toward reduction of liabilities.

Income Taxes. Income taxes are the taxes that must be paid to the federal or state government; they are based on the profits made by the business.

Income taxes represent a cost to the business and therefore are shown on the income statement.

Income Taxes Payable. Income taxes payable represent the taxes payable to the federal or to state or local governments by your business.

Usually, these taxes must be paid only four or five times a year. Therefore, at certain times you will owe the government for taxes not yet paid. These amounts are just like other payables, except that the amounts owed are for income taxes. Income taxes payable are liabilities.

Inventory. This term is most important to those businesses that sell a product. For such businesses, inventory includes the product items that you have purchased or manufactured but have not yet sold. In most businesses that sell products, it is necessary to have a stock of the products to be sold—the inventory.

In some cases, the products being sold are purchased as they are from another company (your supplier) and merely sold to your customer without many changes, except perhaps for putting them in another package. In other cases, the products being sold are manufactured or assembled within the company; if this is so, inventory includes both the completed products and the parts and pieces used to make the product.

Sometimes, supply items such as envelopes, writing paper, and other printed forms might be included as inventory.

Businesses that sell services typically do not have inventory, except for inventories of supply items. Inventory is an asset.

Invoice. An invoice is a bill. You may send a bill to one of your customers, or you may receive a bill from one of your suppliers (called vendors).

A bill sent to a customer is called a *customer invoice*; a bill received from a supplier is called a *vendor invoice*.

Since the words “invoice” or “bill” or “order” are used for these two different things, it can be confusing. Therefore, it is best to always call one a *customer invoice* and the other a *vendor* or *purchase invoice*.

Land. Land is the ground owned by your business.

You may put parking lots, buildings, or other structures on the land, or just leave it empty for later use. Any additions of shrubberies and trees or excavating done to make hills, ponds, and so forth, are also considered land or costs of land.

When this land is owned it appears on the balance sheet; when it is rented it usually does not appear there. Land is an asset.

Landlord’s Waiver. A landlord’s waiver is a legal form signed by the landlord of the premises you may rent for your business. Such a form is usually not necessary unless requested by a supplier, a bank, or other entity.

When signing such a waiver, the landlord is giving assurance that, if you fail to pay the rent, he will *not* try to hold any of your on-premises inventory, furniture, and so forth, until you do pay it.

Liability. A liability is something that is owed by the business to other people or another business. A liability includes such things as payables, income taxes payable, or other obligations of the company.

Liabilities may be caused by incurring any of the following debts:

1. Buying an asset that you do not pay for with cash immediately and for which you owe somebody
2. Costs of operations for payrolls, light bills, and so forth that are not paid for immediately and for which you owe somebody
3. Borrowing cash from a bank or another business, which must be paid back

Some of the liabilities must be paid off in a short time, such as those for payrolls and light bills. Others may not have to be paid off for a longer time, such as amounts borrowed from a bank.

Net Income. Net income is the amount that is left after subtracting all the costs of running the business from the sales made by the business.

Such costs include cost of sales, other operating costs, and income taxes.

Other Operating Costs. Other operating costs include all costs, except those relating directly to the product or service being sold by the business.

Costs relating directly to the product or service fall under cost of sales. Other operating costs include items such as salaries for salespeople, secretaries, and clerks, repairs to office furniture, hospitalization insurance for office employees, and so forth. Other operating costs are deducted from sales in finding net income.

Owner's Equity. Owner's equity represents the amount of cash or other assets that you have put in and have left in the business.

It is found by subtracting the liabilities of the business from the assets of the business; the amount that is left represents your investment in the business.

The dollar amount of your investment in the business merely represents the difference between the assets and the liabilities of the business; the amount is not necessarily what the business is worth. If you sold the business for cash and paid off all of your liabilities, the amount that you would have left might be more or less than what is called your investment in the business.

Partnership. A partnership is one of the three basic forms of legal organization for your company. The other two basic forms are a sole proprietorship or a corporation.

In this form of organization there are two or more owners who organize the business, put in the owners' equity, and share in the profits or losses of the company. Before starting the company the owners (called *partners*) should agree on how much owner's equity each partner must contribute, the extent that each partner will work in the company, the share of the profits or losses to be received by each of them, and so forth. This agreement should be in writing to avoid any future misunderstandings. It is desirable to have the agreement prepared by an attorney. If the business is not successful and the partnership can't pay all it owes, the partners may be required to do so using their personal assets.

Payables. Payables are the amounts of cash that your business owes to other people or businesses.

Many times when you buy a product or service you will immediately pay cash to the seller. At other times you will buy things "on account."

The amount that your business owes is said to be "payable" because you have not yet paid the cash. The opposite of payables is receivables.

Payment on Account. Receivables are defined as the amounts of cash that other people owe you. Whenever they pay a part of that they have made a "payment on account."

Petty Cash. Petty cash is a special kind of cash fund used to pay for minor items.

Generally, you should pay all bills by writing checks. Sometimes however, it may be necessary to buy small items or pay a delivery charge with dollar bills and coins. Therefore, it may be convenient to have a small amount of bills and coins kept in a safe place to use for these needs. These amounts should *not* be kept in the cash register or at least, if they are, they should be kept separate from the other cash in the register.

Receivables. Receivables are the amounts of cash that other people owe to your business.

Many times when you sell the product or service of your business you will immediately receive cash from the buyer. At other times you will sell things on account. The amount that the buyer owes you is said to be "receivable" since you have not yet received the cash.

The opposite of receivables is payables. Receivables are an asset.

Receiving Report. A receiving report is a form on which you, or one of your employees, has written down a description and the quantities of merchandise ordered from a supplier that are being delivered. You do this so that you have a record of what you have received. Later, when you receive a vendor invoice for the items, you should compare the items shown on the bill with the receiving report to make sure that you actually received everything for which you are being billed.

References. References are names of people that you give to someone so that they can contact those people to ask questions about you or your business.

You would do this so that someone could learn about you from other people in order to get separate opinions about your character, personal habits, temperament, and so forth. The persons who are references may be relatives, friends, business associates, or teachers. Usually, the person requesting the references will indicate what sources are necessary.

Sale. A sale occurs when a person or another business buys the product or service of your business.

The amount that is paid to your business is the dollar amount that is added to sales on the first line of your income statement. In some cases the buyer will pay you immediately. In other cases the buyer will merely agree to pay you and will owe you the money. In either case, the dealing is called a *sale*. When the buyer merely agrees to owe you for the sale, a receivable appears on the balance sheet of your business.

Sales Discount. A sales discount is a reduction from the regular price you charge another person or business when they buy something from you.

A discount from the regular price that a customer might pay you can occur in the following situations:

- When the customer pays you cash immediately rather than charging it
- When the customer buys in larger volume, saving you handling and shipping costs, and so forth, you may be able to sell at a reduced price
- When you may have some old or damaged merchandise that can only be sold by reducing the regular price

Signature Card. A signature card is a card requested by a bank when you open a checking account. On this card are placed the signatures of all persons who are allowed to sign checks for your company so that bank personnel can identify those signatures and make sure they are the ones that should be appearing on the checks.

If a signature on one of your business checks is different from that which is on the signature card or it is omitted, the bank may not cash the check.

Sole Proprietorship. A sole proprietorship is one of the three basic forms of legal organization for your company. The other two basic forms are a partnership and a corporation.

In this form of organization there is one owner and if that owner's company should get into a position of owing more to others than the amount of cash and other assets it has, the owner's personal assets (home, car, and so forth) may be required to be sold to pay the obligations of the business.

Trade-Style Registration. A trade-style registration results when you file a form with the state to keep anyone else from using the name of your company. This is not required if your company is a corporation.

This situation is desirable so that there is no confusion between your company and someone else's. It is necessary to file this form only if your company is a sole proprietorship or a partnership; the state will not let any other company use your name. If your company is a corporation, it is not necessary to file this form because the state lets only one corporation use a name.

Vendor. A vendor is a supplier for your company. The supplier may provide you with goods or services.

Examples of vendors are those people or companies who sell the following things to your company:

- Inventory merchandise
- Cleaning supplies
- Forms, paper, stationery, and supplies
- Window washing
- Car and truck repairs

