

Accounting 101 slides

From Lynn Cherny & Greg Raiz's
workshop on consulting

Accounting 101

The 5th Wave

By Rich Tennant



"Cooked books? Let me just say you could serve this profit and loss statement with a fruity Zinfandel and not be out of place."

From the
Bookkeeping for
Dummies
workbook

Accounting Basics

I am not an accountant, and you should hire one, at least to get you started with your book-keeping and expenses.

- Headhunters will ask you if you work **1099 or W2**. “1099” means you take out your own taxes, and is the norm for self-employed.

You can mix up how you work, but it will get complicated doing your estimated taxes/accounting.

- Health insurance is a deductible business expense – and MA’s Commonwealth Choice has cheap options; if you pay yourself (more complex) you can use insurance as a benefit before taxes

High Level for Your Accounting

Estimated quarterly taxes as 1099

- Keep reserves for quarterly taxes, perhaps in another account. (Think 15-20%!)
 - April tax time requires large output of cash: tax you owe, estimated first quarter, anything for SEP IRA or penalties.
- Track your income vs. expenses. (Keep receipts)
- You owe subcontractors 1099's if you pay them more than \$600 for work. (You should also receive 1099's from your clients in this case.)
 - Tip: Bank of America payroll will do this automatically for you with their payroll service if you pay this way.

Some Vocabulary

- “Chart of Accounts” – the list of accounts (like expense accounts) you use; you create them as needed in your software (I use Quickbooks SimpleStart).
- Owner’s Equity – making an “owners draw” means you move money from the business into your personal account. This is a part of your financial picture for your business, so you must record it.
- Cash vs. Accrual basis – how you track your money (we rec you use accrual basis for consulting). All reports are by one of these bases, make sure you know which so you aren’t surprised by the numbers.

Tips for your Chart of Accounts

- Separate your business and personal bank accounts. I track only business in my business software, as an LLC.
 - A credit card for business (not required but simplifies things with the tracking of expenses)
 - An “Accounts Receivable” account (paychecks and direct deposit)
 - An “Accounts Payable” account (pay credit and cash expenses from here, and move money into it from Accounts Receivable)
 - *Reminder: The point of an LLC or Corp is to separate your business from personal, in case of audit/suit to reduce risk to personal assets. So you have to show this to the IRS or law.*
- Create expense accounts for regular expenses (like “Internet”, mapped to Schedule C item – Use “misc” for the random ones that don’t repeat regularly, with a note saying what/why – notes are important in your bookkeeping and expected with “misc” and other items you need to justify)
- Make sure your can summarize your expense accounts as Schedule C mapped items (this is sometimes hidden in your tracking software)

A Basic Balance Sheet

- Assets = Liabilities + Owners Equity







ASSETS		LIABILITIES	
CASH	\$13.00	NOTES PAYABLE	\$ 0.00
INVENTORY	\$ 2.00	OWNER'S EQUITY	
		ORIGINAL INVESTMENT	\$ 5.00
		EARNINGS WEEK TO DATE	\$10.00
TOTAL ASSETS	<u>\$15.00</u>	TOTAL LIABILITIES & OWNER'S EQUITY	<u>\$15.00</u>

From **The Accounting Game**, Orloff and Mullis

If they do, you're "in balance." Notice Owner's Equity on right side showing earnings, which may have been moved to your personal bank account (unless you keep it all in one).

Your Quickbooks accounts reflect this, if you look under the covers. (And you have to! Check in the list of reports you can generate, or the reports for your tax accountant.)

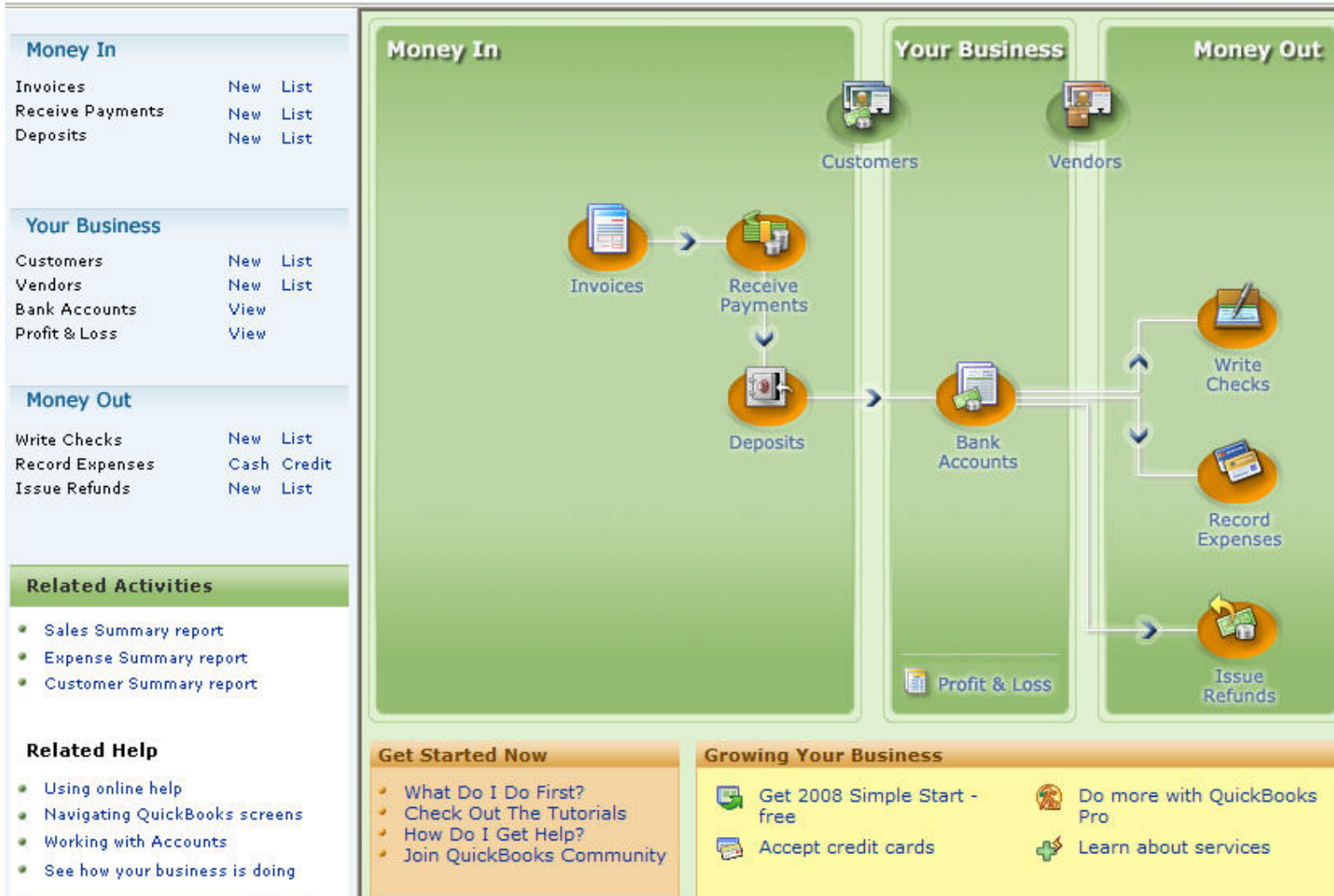
More complicated balance sheet

ASSETS		LIABILITIES	
 CASH	\$46.00	ACCOUNTS PAYABLE	\$32.00
 ACCOUNTS RECEIVABLE	\$16.00	NOTES PAYABLE	\$0.00
 INVENTORY	\$10.00	TAX LIABILITY	\$ 3.00
RAW MATERIALS	\$10	TOTAL LIABILITIES	\$35.00
FINISHED GOODS	\$0		
 PREPAID EXPENSE	\$ 2.00	OWNER'S EQUITY	
 FIXED ASSETS	\$12 \$1 \$11.00	ORIGINAL INVESTMENT	\$ 5.00
 FIXED ASSETS	\$20 \$4 \$16.00	RETAINED EARNINGS	\$52.00
		EARNINGS WEEK TO DATE	\$ 9.00
		TOTAL OWNER'S EQUITY	\$66.00
TOTAL ASSETS	\$101.00	TOTAL LIABILITIES & OWNER'S EQUITY	\$101.00

From **The Accounting Game**, Orloff and Mullis

Types of Accounts you will have in your book-keeping software: Expenses, Payable, Receivable, Assets, Cash, Equity. You may name them something else like "Internet Service" but they will be mapped as an "expense account" so that your books work out.

Quickbooks SimpleStart Screen



Warning:
It may look simple, but it's actually complicated to use it right. I needed a lot of help to do it right and still am not entirely fixed from a bad start.

In Quickbooks, the Balance Sheet is an Accountant Report Type, hidden in menus.

Accrual Basis

Assets = Liabilities + Owners Equity
This person is in balance in this picture !

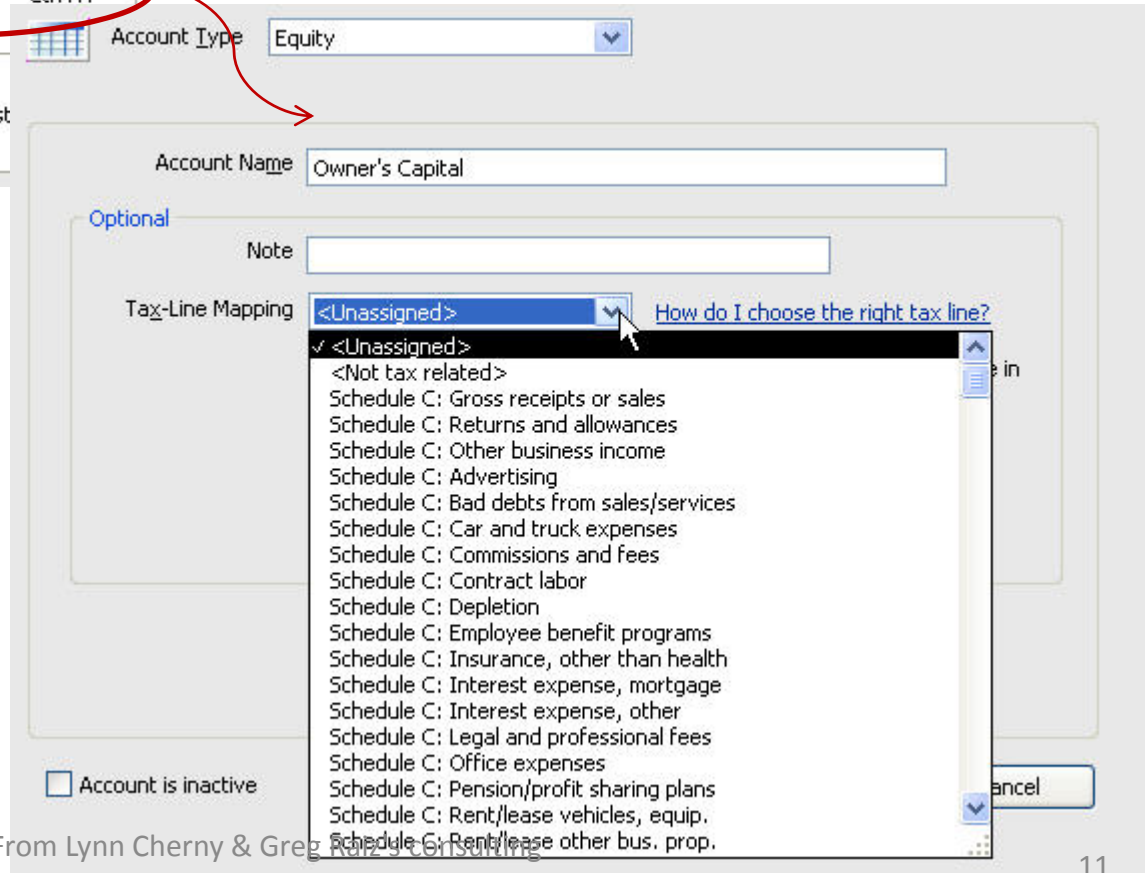
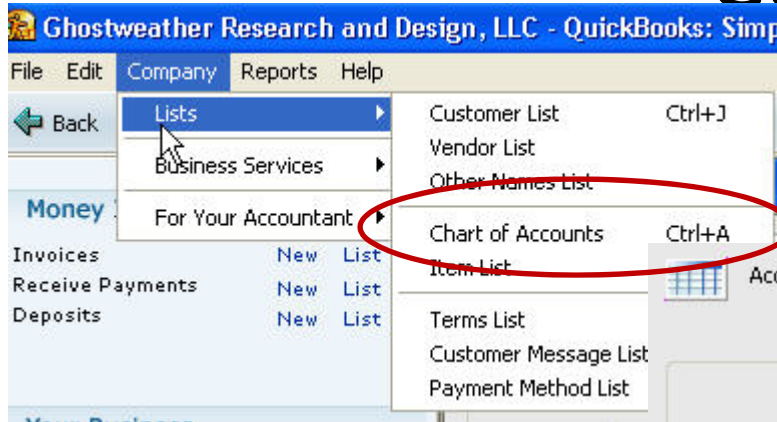
As of July 18, 2008

◇ Jul 18, 08 ◇

ASSETS	
Current Assets	
Checking/Savings	
Accounts Receivable	
Other Current Assets	
Total Current Assets	
TOTAL ASSETS	<u>78,417.92</u>
LIABILITIES & EQUITY	
Liabilities	
Current Liabilities	
Credit Cards	
Total Current Liabilities	
Total Liabilities	
Equity	
TOTAL LIABILITIES & EQUITY	<u>78,417.92</u>

Accounts in Quickbooks: Map them Correctly

By mapping an account to a type, Quickbook keeps you “in balance” – but you need to check that you’ve assigned the right types!



Try to keep your expense accounts mapped to Schedule C items for taxes, and understand what goes to what. Being similar is a good idea (I was not, to start with).

The Income Statement, or Profit and Loss Statement

Sales - Cost of services (or Cost of Goods Sold, "COGS")

= **Gross Profit**

- Expenses

= **Net Profit**

(Make sure you check if you are showing it accrual or cash basis! This changes your numbers!)

Example from Another Business...

- From wikipedia:

- INCOME STATEMENT BOND LLC -		
For the year ended DECEMBER 31 2007		
	\$	\$
Revenues:		
GROSS PROFIT (including rental income)		496,397

Expenses:		
ADVERTISING	6,300	
INSURANCE	750	
LEGAL & PROFESSIONAL SERVICES	1,575	
RENT	13,000	
UTILITIES	491	
PRINTING, POSTAGE & STATIONERY	320	
ENTERTAINMENT	5,550	
LICENSES	632	
BANK & CREDIT CARD FEES	144	
BOOKKEEPING	3,350	
EMPLOYEES	88,000	
RENTAL MORTGAGES AND FEES	74,400	

TOTAL EXPENSES		(194,512)

NET INCOME		301,885
		=====

Deductions and Expenses

Small businesses deduct up to 30% without IRS looking too carefully. Survey says...

7. What approximate percentage of your annual gross income do you reinvest in the business (i.e., consider business expenses)?

		Response Percent	Response Count
Less than 5%		13.0%	13
Between 5% and 10%		29.0%	29
Between 10% and 15%		12.0%	12
Between 15% and 20%		13.0%	13
Between 20% and 30%		20.0%	20
Between 30% and 40%		6.0%	6
More than 40%		7.0%	7

From Lynn Cherny & Greg Raiz's consulting workshop

Depreciation of Capital Assets

- Capital expenses over \$1000 get considered for depreciation – simplify by staying under if you can? Note these items in your records as possible for depreciation for your tax time.
- My advice: Do this with an accountant.



Normal Car Expenses

See publication 463 from IRS.

- Simpler: Write off your mileage – you can estimate as you go, or later (if you have good regular travel): In 2008, 50.5 cents per mile are deductible.
- You can deduct your actual car expenses at the percent you use it for business. This requires tracking all expenses and times/how you use car.



Meals and Entertainment

- For business purposes, those not reimbursed by your client. Also, meals on client sites (during work) count for expensing!
- Deductible at 50%. Keep your receipts!
- This should be pretty large – it's your main networking method.



Travel Per Diems for Consultants




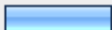







See publication 463 from the IRS.

- Sole proprietors can use per diems for meals in a city, but not for hotels (save your receipts for the hotel, but you can do better by the per diem rate for meals, it's likely)
 - Expensive cities are worth using the per diem, like NYC!
- Travel to client site may or may not be billable time – long drive? You can require it of client in the statement of work/contract.



Remember: Never go on a purely non-work vacation again! (Flight is deductible, at least.)

If they have employees or subcontractors, this is highest expense; otherwise it's software or hardware or travel for most.

6. What is your largest category of expenses for your business? (These are broken down a little differently than as required for American taxes, so try to estimate your largest contributor if you are from the U.S.)			
		Response Percent	Response Count
Software		12.3%	8
Hardware (computers, disk drives, etc)		10.8%	7
Office supplies apart from computer (including books)		1.5%	1
Salary of employees/subcontractors		23.1%	15
Insurance		9.2%	6
Travel-related		15.4%	10
Conference/workshop fees		3.1%	2
Meals/entertainment with others for work		3.1%	2
Cell phone, internet, other communication expenses		7.7%	5
Legal and professional fees (such as memberships)		6.2%	4
Other		7.7%	5

More Reminders

- Have a cash cushion to be safe – 3-6 months living expenses and tax money put away if you can manage it. (A financial advisor will tell you this, mine did.)
- You can use a **SEP IRA** to save on tax load – and continue to save for retirement while consulting.
- Some items that are deductible may not be easy to record in your bookkeeping software (like miles traveled for work) – use a spreadsheet and don't forget this one at tax time!
- **Long term disability insurance** isn't free/cheap/easy to get, but is a good idea if you can get it. They will check medical records and do tests. Existing conditions often prevent you from getting it.

Get a financial advisor and tax accountant who know small business/self-employment and IRS concerns.