The Basics Of Financial Management For The Business

A successful small business needs a CEO that understands some basics about financial management. As a starter, whether or not you personally handle your small business’s bookkeeping, there are some essential bookkeeping terms every business owner must know.

**What standard is recommended for a small business?** GAAP (Generally Accepted Accounting Principles) is the accounting standard used by most U.S. small businesses. This is used by almost all small businesses. However, The American Institute of CPAs (AICPA) recently endorsed a different set of standards that can be used by small and midsized businesses called IFRS for SME (International Financial Reporting Standards for Small and Midsized Enterprises). If your company does business internationally, IFRS for SME may be more appropriate.

**What method of accounting (Cash vs. Accrual) is best for my business?** Cash basis businesses recognize income and expenses when they are paid or received, not when a product or service is delivered. Accrual basis businesses recognize income and expenses when they are incurred rather than when they are received.

The IRS generally gives business owners latitude to elect to use either accrual or cash basis bookkeeping. Most service businesses prefer to be cash basis bookkeeping. However, if your business carries substantial inventory, the IRS requires you to be an accrual basis bookkeeper.

In addition, many small businesses operate on what is informally known as a “modified” cash basis. That means the company keeps its books internally using an accrual method but pays income taxes based on a cash basis.

There is no significant advantage to using cash basis bookkeeping instead of accrual, especially if you use accounting software. Using accrual basis financial statements will help you better understand how your business is operating and is typically required when applying for a business loan. Work with your accountant and your SCORE mentor to determine which accounting method is best for your business.

When you are preparing company reports using accounting programs like QuickBooks, you can choose to see the output on either a cash basis or accrual basis. Assuming you have entered all your payables and receivables, printing these reports using the accrual filter shows your financial position as if you are an accrual bookkeeper, even if you aren’t.

The important consideration here is that the CEO establishes a system that he or she understands and then uses the data reports from it to manage the business. I will follow up on a few topics of financial management in the next several columns.

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