



## Good Business Practices

Two (2) Continuing Education Hour  
Course #BP202

Approved Continuing Education for Licensed Professional Engineers

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## Good Business Practices

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# Good Business Practices

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## LEARNING OBJECTIVES

*Upon completion of this course the student will be able to:*

1. Learn about the different types of business structures and find the one best suited for their business.
  2. Explain the concept of time management and why is it important to their business
  3. Learn and apply time management tools & techniques to increase their time efficiency
  4. Explain the concept of financial management and why it is important to a small business
  5. Understand the importance and use of budgeting, bookkeeping, cash flow analysis, and profit & loss statements
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## Introduction

This course examines the basics of operating a small engineering contracting business and provides essential tips for engineers and contracting businesses of all sizes. This course is broken into three informational sections that discuss the following: the legal structures of businesses, financial management, & time management.

### BUSINESS STRUCTURES

When beginning a business, you must decide what form of business entity to establish. Your form of business determines which income tax return form you have to file. The most common forms of business are the sole proprietorship, partnership, corporation, and S corporation. A Limited Liability Company (LLC) is a business structure allowed by state statute. Legal and tax considerations enter into selecting a business structure.

### SOLE PROPRIETORSHIPS

A sole proprietorship is the simplest and most common structure chosen to start a business. It is an unincorporated business owned and run by one individual with no distinction between the business and you, the owner. You are entitled to all profits and are responsible for all your business's debts, losses and liabilities.

### Forming a Sole Proprietorship

You do not have to take any formal action to form a sole proprietorship. As long as you are the only owner, this status automatically comes from your business activities. In fact, you may already own

one without knowing it. If you are a freelance writer, for example, you are a sole proprietor.

But like all businesses, you need to obtain the necessary licenses and permits. Regulations vary by industry, state and locality. Use the Licensing & Permits tool to find a listing of federal, state and local permits, licenses and registrations you'll need to run a business.

If you choose to operate under a name different than your own, you will most likely have to file a fictitious name (also known as an assumed name, trade name, or DBA name, short for "doing business as"). You must choose an original name; it cannot already be claimed by another business.

### Sole Proprietor Taxes

Because you and your business are one and the same, the business itself is not taxed separately—the sole proprietorship income is your income. You report income and/or losses and expenses with a Schedule C and the standard Form 1040. The "bottom-line amount" from Schedule C transfers to your personal tax return. It's your responsibility to withhold and pay all income taxes, including self-employment and estimated taxes. You can find more information about sole proprietorship taxes and other forms at [IRS.gov](https://www.irs.gov).

### Advantages of a Sole Proprietorship

- **Easy and inexpensive to form:** A sole proprietorship is the simplest and least expensive business structure to establish. Costs are minimal, with legal costs limited to obtaining the necessary license or permits.

- **Complete control.** Because you are the sole owner of the business, you have complete control over all decisions. You aren't required to consult with anyone else when you need to make decisions or want to make changes.
- **Easy tax preparation.** Your business is not taxed separately, so it's easy to fulfill the tax reporting requirements for a sole proprietorship. The tax rates are also the lowest of the business structures.

### Disadvantages of a Sole Proprietorship

- **Unlimited personal liability.** Because there is no legal separation between you and your business, you can be held personally liable for the debts and obligations of the business. This risk extends to any liabilities incurred as a result of employee actions.
- **Hard to raise money.** Sole proprietors often face challenges when trying to raise money. Because you can't sell stock in the business, investors won't often invest. Banks are also hesitant to lend to a sole proprietorship because of a perceived lack of credibility when it comes to repayment if the business fails.
- **Heavy burden.** The flipside of complete control is the burden and pressure it can impose. You alone are ultimately responsible for the successes and failures of your business.

## PARTNERSHIPS

A partnership is a single business where two or more people share ownership.

Each partner contributes to all aspects of the business, including money, property, labor or skill. In return, each partner shares in the profits and losses of the business.

Because partnerships entail more than one person in the decision-making process, it's important to discuss a wide variety of issues up front and develop a legal partnership agreement. This agreement should document how future business decisions will be made, including how the partners will divide profits, resolve disputes, change ownership (bring in new partners or buy out current partners) and how to dissolve the partnership. Although partnership agreements are not legally required, they are strongly recommended and it is considered extremely risky to operate without one.

### Types of Partnerships

There are three general types of partnership arrangements:

**General Partnerships** assume that profits, liability and management duties are divided equally among partners. If you opt for an unequal distribution, the percentages assigned to each partner must be documented in the partnership agreement.

**Limited Partnerships** (also known as a partnership with limited liability) are more complex than general partnerships. Limited partnerships allow partners to have limited liability as well as limited input with management decisions. These limits depend on the extent of each partner's investment percentage. Limited partnerships are attractive to investors of short-term projects.

**Joint Ventures** act as general partnership, but for only a limited period of time or for a single project. Partners in a joint venture can be recognized as an ongoing partnership if they continue the venture, but they must file as such.

### Forming a Partnership

To form a partnership, you must register your business with your state, a process generally done through your Secretary of State's office.

You'll also need to establish your business name. For partnerships, your legal name is the name given in your partnership agreement or the last names of the partners. If you choose to operate under a name different than the officially registered name, you will most likely have to file a fictitious name (also known as an assumed name, trade name, or DBA name, short for "doing business as").

Once your business is registered, you must obtain business licenses and permits. Regulations vary by industry, state and locality. Use our Licensing & Permits tool to find a listing of federal, state and local permits, licenses and registrations you'll need to run a business.

If you are hiring employees, read more about federal and state regulations for employers.

### Partnership Taxes

Most businesses will need to register with the IRS, register with state and local revenue agencies, and obtain a tax ID number or permit.

A partnership must file an “annual information return” to report the income, deductions, gains and losses from the business’s operations, but the business itself does not pay income tax. Instead, the business “passes through” any profits or losses to its partners. Partners include their respective share of the partnership’s income or loss on their personal tax returns.

Partnership taxes generally include:

- Annual Return of Income
- Employment Taxes
- Excise Taxes

Partners in the partnership are responsible for several additional taxes, including:

- Income Tax
- Self-Employment Tax
- Estimated Tax

### Filing information for partnerships:

- Partnerships must furnish copies of their Schedule K-1 (Form 1065) to all partners by the date Form 1065 is required to be filed, including extensions.
- Partners are not employees and should not be issued a Form W-2.

### Advantages of a Partnership

- **Easy and Inexpensive.** Partnerships are generally an inexpensive and easily formed business structure. The majority of time spent starting a partnership often focuses on developing the partnership agreement.
- **Shared Financial Commitment.** In a partnership, each partner is equally invested in the success of the business. Partnerships have the advantage of pooling resources to obtain capital. This could be beneficial in terms of securing credit, or by simply doubling your seed money.
- **Complementary Skills.** A good partnership should reap the benefits of being able to utilize the strengths, resources and expertise of each partner.
- **Partnership Incentives for Employees.** Partnerships have an employment advantage over other entities if they offer employees the opportunity to become a partner. Partnership incentives often attract highly motivated and qualified employees.

### Disadvantages of a Partnership

- **Joint and Individual Liability.** Similar to sole proprietorships, partnerships retain full, shared liability among the owners. Partners are not only liable for their own actions, but also for the business debts and decisions made by other partners. In addition, the personal assets of all partners can be used to satisfy the partnership’s debt.
- **Disagreements Among Partners.** With multiple partners, there are bound to be disagreements. Partners should consult each other on all decisions, make compromises, and resolve disputes as amicably as possible.
- **Shared Profits.** Because partnerships are jointly owned, each partner must share the successes and profits of their business with the other partners. An unequal contribution of time, effort, or resources can cause discord among partners.

## CORPORATIONS

A corporation (sometimes referred to as a C corporation) is an independent legal entity owned by shareholders. This means that the corporation itself, not the shareholders that own it, is held legally liable for the actions and debts the business incurs.

Corporations are more complex than other business structures because they tend to have costly administrative fees and complex tax and legal requirements. Because of these issues, corporations are generally suggested for established, larger companies with multiple employees.

For businesses in that position, corporations offer the ability to sell ownership shares in the business through stock offerings. “Going public” through an initial public offering (IPO) is a major selling point in attracting investment capital and high quality employees.

### Forming a Corporation

A corporation is formed under the laws of the state in which it is registered. To form a corporation you’ll need to establish your business name and register your legal name with your state government. If you choose to operate under a name different than the officially registered name, you’ll most likely have to file a fictitious name (also known as an assumed name, trade name, or DBA

name, short for "doing business as"). State laws vary, but generally corporations must include a corporate designation (Corporation, Incorporated, Limited) at the end of the business name.

To register your business as a corporation, you need to file certain documents, typically articles of incorporation, with your state's Secretary of State office. Some states require corporations to establish directors and issue stock certificates to initial shareholders in the registration process. Contact your state business entity registration office to find out about specific filing requirements in the state where you form your business.

Once your business is registered, you must obtain business licenses and permits. Regulations vary by industry, state and locality. Use our Licensing & Permits tool to find a listing of federal, state and local permits, licenses and registrations you'll need to run a business.

If you are hiring employees, read more about federal and state regulations for employers.

### Corporation Taxes

Corporations are required to pay federal, state, and in some cases, local taxes. Most businesses must register with the IRS and state and local revenue agencies, and receive a tax ID number or permit.

When you form a corporation, you create a separate tax-paying entity. Regular corporations are called "C corporations" because Subchapter C of Chapter 1 of the Internal Revenue Code is where you find general tax rules affecting corporations and their shareholders.

Unlike sole proprietors and partnerships, corporations pay income tax on their profits. In some cases, corporations are taxed twice - first, when the company makes a profit, and again when dividends are paid to shareholders on their personal tax returns. Corporations use IRS Form 1120 or 1120-A, U.S. Corporation Income Tax Return to report revenue to the federal government.

Shareholders who are also employees pay income tax on their wages. The corporation and the employee each pay one half of the Social Security and Medicare taxes, but this is usually a deductible business expense.

### Advantages of a Corporation

- **Limited Liability.** When it comes to taking responsibility for business debts and actions of a corporation, shareholders' personal assets are protected. Shareholders can generally only be held accountable for their investment in stock of the company.
- **Ability to Generate Capital.** Corporations have an advantage when it comes to raising capital for their business - the ability to raise funds through the sale of stock.
- **Corporate Tax Treatment.** Corporations file taxes separately from their owners. Owners of a corporation only pay taxes on corporate profits paid to them in the form of salaries, bonuses, and dividends, while any additional profits are awarded a corporate tax rate, which is usually lower than a personal income tax rate.
- **Attractive to Potential Employees.** Corporations are generally able to attract and hire high-quality and motivated employees because they offer competitive benefits and the potential for partial ownership through stock options.

### Disadvantages of a Corporation

- **Time and Money.** Corporations are costly and time-consuming ventures to start and operate. Incorporating requires start-up, operating and tax costs that most other structures do not require.
- **Double Taxing.** In some cases, corporations are taxed twice - first, when the company makes a profit, and again when dividends are paid to shareholders.
- **Additional Paperwork.** Because corporations are highly regulated by federal, state, and in some cases local agencies, there are increased paperwork and recordkeeping burdens associated with this entity

## S CORPORATIONS

An S corporation (sometimes referred to as an S Corp) is a special type of corporation created through an IRS tax election. An eligible domestic corporation can avoid double taxation (once to the corporation and again to the shareholders) by electing to be treated as an S corporation.

An S corp is a corporation with the Subchapter S designation from the IRS. To be considered an S corp, you must first charter a business as a corporation in the state where it is headquartered.

According to the IRS, S corporations are "considered by law to be a unique entity, separate and apart from those who own it." This limits the financial liability for which you (the owner, or "shareholder") are responsible. Nevertheless, liability protection is limited - S corps do not necessarily shield you from all litigation such as an employee's tort actions as a result of a workplace incident.

What makes the S corp different from a traditional corporation (C corp) is that profits and losses can pass through to your personal tax return. Consequently, the business is not taxed itself. Only the shareholders are taxed. There is an important caveat, however: any shareholder who works for the company must pay him or herself "reasonable compensation." Basically, the shareholder must be paid fair market value, or the IRS might reclassify any additional corporate earnings as "wages."

### Forming an S Corporation

Before you form an S Corporation, determine if your business will qualify under the IRS stipulations

To file as an S Corporation, you must first file as a corporation. After you are considered a corporation, all shareholders must sign and file Form 2553 to elect your corporation to become an S Corporation.

Once your business is registered, you must obtain business licenses and permits. Regulations vary by industry, state and locality. Use the Licensing & Permits tool to find a listing of federal, state and local permits, licenses, and registrations you'll need to run a business.

If you are hiring employees, read more about federal and state regulations for employers.

### Combining the Benefits of an LLC with an S Corp

There is always the possibility of requesting S Corp status for your LLC. Your attorney can advise you on the pros and cons. You'll have to make a special election with the IRS to have the LLC taxed as an S corp using Form 2553. And you must file it before the first two months and fifteen days of the beginning of the tax year in which the election is to take effect.

The LLC remains a limited liability company from a legal standpoint, but for tax purposes it's treated

as an S corp. Be sure to contact your state's income tax agency where you will file the election form to learn about tax requirements.

### S Corporation Taxes

Most businesses need to register with the IRS, register with state and local revenue agencies, and obtain a tax ID number or permit.

All states do not tax S corps equally. Most recognize them similarly to the federal government and tax the shareholders accordingly. However, some states (like Massachusetts) tax S corps on profits above a specified limit. Other states don't recognize the S corp election and treat the business as a C corp with all of the tax ramifications. Some states (like New York and New Jersey) tax both the S corps profits and the shareholder's proportional shares of the profits.

Your corporation must file the Form 2553 to elect "S" status within two months and 15 days after the beginning of the tax year or any time before the tax year for the status to be in effect.

### Advantages of an S Corporation

- **Tax Savings.** One of the best features of the S Corp is the tax savings for you and your business. While members of an LLC are subject to employment tax on the entire net income of the business, only the wages of the S Corp shareholder who is an employee are subject to employment tax. The remaining income is paid to the owner as a "distribution," which is taxed at a lower rate, if at all.
- **Business Expense Tax Credits.** Some expenses that shareholder/employees incur can be written off as business expenses. Nevertheless, if such an employee owns 2% or more shares, then benefits like health and life insurance are deemed taxable income.
- **Independent Life.** An S corp designation also allows a business to have an independent life, separate from its shareholders. If a shareholder leaves the company, or sells his or her shares, the S corp can continue doing business relatively undisturbed. Maintaining the business as a distinct corporate entity defines clear lines between the shareholders and the business that improve the protection of the shareholders.

### Disadvantages of an S Corporation

- **Stricter Operational Processes.** As a separate structure, S corps require scheduled director and shareholder meetings, minutes from those meetings, adoption and updates to by-laws, stock transfers and records maintenance.
- **Shareholder Compensation Requirements.** A shareholder must receive reasonable compensation. The IRS takes notice of shareholder red flags like low salary/high distribution combinations, and may reclassify your distributions as wages. You could pay a higher employment tax because of an audit with these results.

### LIMITED LIABILITY COMPANY (LLC)

A limited liability company is a hybrid type of legal structure that provides the limited liability features of a corporation and the tax efficiencies and operational flexibility of a partnership.

The "owners" of an LLC are referred to as "members." Depending on the state, the members can consist of a single individual (one owner), two or more individuals, corporations or other LLCs.

Unlike shareholders in a corporation, LLCs are not taxed as a separate business entity. Instead, all profits and losses are "passed through" the business to each member of the LLC. LLC members report profits and losses on their personal federal tax returns, just like the owners of a partnership would.

#### Forming an LLC

While each state has slight variations to forming an LLC, they all adhere to some general principles:

**Choose a Business Name.** There are 3 rules that your LLC name needs to follow: (1) it must be different from an existing LLC in your state, (2) it must indicate that it's an LLC (such as "LLC" or "Limited Company") and (3) it must not include words restricted by your state (such as "bank" and "insurance"). Your business name is automatically registered with your state when you register your business, so you do not have to go through a separate process. Read more here about choosing a business name.

**File the Articles of Organization.** The "articles of organization" is a simple document that legitimizes your LLC and includes information like your business name, address, and the names of its members. For most states, you file with the Secretary of State. However, other states may

require that you file with a different office such as the State Corporation Commission, Department of Commerce and Consumer Affairs, Department of Consumer and Regulatory Affairs, or the Division of Corporations & Commercial Code. Note: there may be an associated filing fee.

**Create an Operating Agreement.** Most states do not require operating agreements. However, an operating agreement is highly recommended for multi-member LLCs because it structures your LLC's finances and organization, and provides rules and regulations for smooth operation. The operating agreement usually includes percentage of interests, allocation of profits and losses, member's rights and responsibilities and other provisions.

**Obtain Licenses and Permits.** Once your business is registered, you must obtain business licenses and permits. Regulations vary by industry, state and locality. Use the Licensing & Permits tool to find a listing of federal, state and local permits, licenses and registrations you'll need to run a business.

**Hiring Employees.** If you are hiring employees, read more about federal and state regulations for employers.

**Announce Your Business.** Some states, including Arizona and New York, require the extra step of publishing a statement in your local newspaper about your LLC formation. Check with your state's business filing office for requirements in your area.

#### LLC Taxes

In the eyes of the federal government, an LLC is not a separate tax entity, so the business itself is not taxed. Instead, all federal income taxes are passed on to the LLC's members and are paid through their personal income tax. While the federal government does not tax income on an LLC, some states do, so check with your state's income tax agency.

Since the federal government does not recognize LLC as a business entity for taxation purposes, all LLCs must file as a corporation, partnership, or sole proprietorship tax return. Certain LLCs are automatically classified and taxed as a corporation by federal tax law. For guidelines about how to classify an LLC, visit IRS.gov.

LLCs that are not automatically classified as a corporation can choose their business entity

classification. To elect a classification, an LLC must file Form 8832. This form is also used if an LLC wishes to change its classification status. Read more about filing as a corporation or partnership and filing as a single member LLC at [IRS.gov](https://www.irs.gov).

You should file the following tax forms depending on your classification:

- **Single Member LLC.** A single-member LLC files Form 1040 Schedule C like a sole proprietor.
- **Partners in an LLC.** Partners in an LLC file a Form 1065 partnership tax return like owners in a traditional partnership.
- **LLC filing as a Corporation.** An LLC designated as a corporation files Form 1120, the corporation income tax return.

### Combining the Benefits of an LLC with an S-Corp

There is always the possibility of requesting S-Corp status for your LLC. An attorney can advise you on the pros and cons. You'll have to make a special election with the IRS to have the LLC taxed as an S-Corp using Form 2553. You must file prior to the first two months and fifteen days of the beginning of the tax year in which the election is to take effect. For more information about S-Corp status, visit [IRS.gov](https://www.irs.gov) or read *Should My Company be an LLC, an S-Corp or Both?*

The LLC remains a limited liability company from a legal standpoint, but for tax purposes it can be treated as an S-Corp. Be sure to contact the state's income tax agency where you plan to file your election form. Ask about the tax requirements and if they recognize elections of other entities (such as the S-Corp).

### Advantages of an LLC

- **Limited Liability.** Members are protected from personal liability for business decisions or actions of the LLC. This means that if the LLC incurs debt or is sued, members' personal assets are usually exempt. This is similar to the liability protections afforded to shareholders of a corporation. Keep in mind that limited liability means "limited" liability - members are not necessarily shielded from wrongful acts, including those of their employees.
- **Less Recordkeeping.** An LLC's operational ease is one of its greatest advantages. Compared to an

S-Corporation, there is less registration paperwork and there are smaller start-up costs.

- **Sharing of Profits.** There are fewer restrictions on profit sharing within an LLC, as members distribute profits as they see fit. Members might contribute different proportions of capital and sweat equity. Consequently, it's up to the members themselves to decide who has earned what percentage of the profits or losses.

### Disadvantages of an LLC

- **Limited Life.** In many states, when a member leaves an LLC, the business is dissolved and the members must fulfill all remaining legal and business obligations to close the business. The remaining members can decide if they want to start a new LLC or part ways. However, you can include provisions in your operating agreement to prolong the life of the LLC if a member decides to leave the business.
- **Self-Employment Taxes.** Members of an LLC are considered self-employed and must pay the self-employment tax contributions towards Medicare and Social Security. The entire net income of the LLC is subject to this tax

## FINANCIAL MANAGEMENT

### Benefits of Financial Management

Quality financial management offers many benefits to you as a business owner. Financial management includes bookkeeping, projections, financial statements, and financing, which forms the foundation for reaching your goals through sound business decisions.

Financial management is one of your main avenues to success as a business owner. Financial management is the way you know if you are making a profit. Financial management helps you decide what you can afford in terms of store or office location, inventory purchases, employees, and equipment. You need sound financial information to set your prices and select your vendors. Financial management gives you the tools to plan for overall business growth, for diversification of your product lines, or for reaching new markets. Financial management helps you decide which products, services, and markets are profitable. Effective financial management gives you tools to chart your course into the future, adjust your direction when needed,

and help you find your way through challenging times.

If your business growth requires financing (loans), financial management provides the information to know how much you can afford for your business. Financial management gives you not only the documentation needed for a loan application, but also helps you discuss your business circumstances with a lender in terms that improve your ability to qualify for the loan.

### BUDGETING

Creating a budget is the first place to start with your financial management practice. A budget is a list of all your (monthly or yearly) expenses, organized by categories. A budget is a tool that helps you:

- Track all your business expenses
- Plan for the future
- Economize when you need to
- Plan for expansion
- Make a profit

Once you create a budget, use it to compare what you've budgeted with your actual expenditures.

### BOOKKEEPING

Bookkeeping is the organized process of tracking all income and expense transactions. Bookkeeping is a critical component of financial management, which leads to better business decisions regarding financing, taxes, owner's draw, and retirement.

**Here are eleven basic bookkeeping steps:**

1. **Obtain business accounting software.** Proper software selection is critical for success.
2. **Open a separate business checking account.** Do not mix business and personal checking accounts.
3. **Reconcile your checking account.** Each month, reconcile your account using business accounting software or a cloud computing reconciliation process.
4. **Track sales.** Create an airtight system for tracking sales using tools such as a register tape, invoices, and a sales book. Always use this sales tracking system.
5. **Deposit all sales.** Using the duplicating deposit slips, deposit all sales in your business checking account.

Total sales should equal total deposits. Do not spend cash sales. Link all forms of sales documentation (such as invoices, cash register tapes, and sales books) with a specific deposit.

6. **Write business checks for all business expenses** (or use a business check card). Don't use a petty cash system until you are experienced at bookkeeping.

7. **Obtain a separate business credit card.** If you plan to use a credit card for business expenses, consider obtaining a card in your company's name. Doing so will help you keep track of business expenses.

8. **Pay business expenses first. Most businesses start out as a sole proprietorship.** In sole proprietorships, you, the owner, do not get a salary; rather you take an owner's draw. A common question is how much draw to take?

Here's a rule of thumb: Sales pays for business expenses first, personal expenses second (step 10, below).

9. **Run a profit and loss (P&L) statement.** A checking account balance is not a good indication of how much profit the business has made or what amount is available for owner's draw. A P&L statement can provide a better picture of the financial health of the organization.

10. **Pay yourself with owner's draw.** Owners should pay themselves by writing a check or making an electronic transfer from the business account to a personal account. If you are a sole proprietor, assign those draw checks to an equity account called "Draws."

### CASH FLOW

#### Developing a Cash Flow Analysis

For small businesses, cash is king. You need it to start, operate, and expand your operations, but many small business owners often have trouble managing and maintaining cash. Inaccurate cash flow analysis - or lack of available cash - can affect the everyday operations of your business and your eligibility to receive a loan.

Cash flow is the movement of money in and out of your business. The process includes:

- **Inflow** which comes from operations such as the sale of goods and services, loans, lines of credit, and asset sales.
- **Outflow** which occurs during operations such as business expenditures, loan payments, and business purchases.

It's crucial to balance these two figures and maintain a reasonable balance of cash at all times. An effective cash flow system will help you manage funds to cover operational costs and bills and help you foresee potential problems in the future.

Profit and loss statements and income statements can be used to determine projections for future cash flow trends of your business. These financial documents are instrumental in making cash flow projections. However, a cash flow statement serves an important and independent purpose - it accounts for non-cash items and expenses to adjust profit figures. Cash flow analysis statements display not only changes over time, but also available net cash.

Cash flow analysis statements are generally separated into three parts:

- **Operating activities:** This section evaluates net income and losses of a business. By assessing sales and business expenditures, all income from non-cash items is adjusted to incorporate inflows and outflows of cash transactions to determine a net figure.
- **Investment activities:** This section reports inflows and outflows from purchases and sales of long-term business investments such as property, assets, equipment, and securities. For example - if your construction business purchases an additional industrial generator, this would be considered an investment and accounted for as an outflow of cash. If your business then sold equipment that was no longer needed, this would be considered an inflow of cash.
- **Financing activities:** This section accounts for the cash flow trends of all money that is related to financing your business. For example: if you received a loan for your small business, the loan itself would be considered an inflow of cash. Loan payments would be considered an outflow of cash, and both would be recorded in this part of the cash flow analysis statement.

## Cash Flow Projection

A cash flow projection is a financial statement that tries to show how cash is expected to flow in and out of a business over a future period of time. A cash flow projection is used to see if projected cash receipts (in flows) will be sufficient to cover projected cash disbursements (out flows). A business can be profitable and still run out of cash. As an investment banker might say, "Cash flow projections provide the visibility needed to avoid liquidity problems." In other words, a cash flow projection is a tool to help you manage your cash so you can pay your bills on a timely basis and keep the doors of your business open.

A cash flow projection is a great tool for setting sales goals and for planning for expenses to support those sales. A related use for a projection is to determine your breakeven point during a start-up or expansion phase. If you need to plan for a large expenditure, such as an equipment purchase or move to a new location, a cash flow projection is the perfect tool. Similarly, if you have a seasonal business with large inventory purchases, a projection can help you have the cash on hand to make a large inventory investment when you need it.

A P&L statement can mask cash shortages if you use accrual accounting. A cash flow projection helps you see the cash status of your business now and plan into the future. A cash flow projection is a good way to prepare and plan for your financing needs and is often a required part of a business loan application.

## PROFIT AND LOSS (P&L) STATEMENT

The P&L statement is the best tool for knowing if your business is profitable. A P&L statement measures revenue (also called sales or income) and expenses over a month, quarter or year. With it you know if you have made a profit (and how much) or if you have incurred a loss.

The most important financial management report is the P&L statement. A P&L statement will reflect your business decisions on the basic buying and selling process. A P&L will tell you how well you are managing your business and provide information on how to grow your business.

### Basic Formula for P&L Statement

$$\begin{aligned}
 &+ \text{Sales} \\
 &- \text{Cost of Goods Sold} \\
 &= \text{Gross Profit}
 \end{aligned}$$

- Overhead

= Net Profit

- **Sales (also called Income or Revenue):** Total amount from selling your product or service during a certain time period.
- **Cost of Goods Sold:** Total expenditure for inventory items which customers buy. Cost of Goods Sold consists of the cost of purchasing the items, freight, manufacturing costs, modification costs, and packaging. For services, this is the cost of providing the services, including labor, material used, and transportation.
- **Gross Profit:** Sales less Cost of Goods Sold.
- **Overhead:** Expenses associated with your ongoing business operation, such as rent or utilities.
- **Net Profit:** Gross Profit less Overhead. Net Profit is what remains to pay for expansion, equipment, loan repayment, income taxes and owner's draw.

### Compiling a P&L Statement

All quality business accounting software programs compile a P&L statement at the push of a button. The accuracy of your P&L statement will depend on how it is set up for your company and your input data. Print out your P&L regularly to track your business progress. Use your P&L statement as the basis for building a cash flow projection.

#### FOUR KEY POINTS TO REMEMBER

1. Start financial management with a budget.
3. Sound bookkeeping is the basis for all financial management.
4. Cash flow projections will help you to see cash shortages even when accrual accounting may mask these shortages.
5. A Profit & Loss (P&L) statement is the best tool for knowing if your business is profitable.

## TIME MANAGEMENT

### Importance of Time Management

Is the saying, "Time is money," true? If your business runs out of money, you always have the opportunity to get more. More money is "simply a job away." On the other hand, once time is past you can never get that time back nor can you add

more hours to a day. Yes, poor time management can cost you and your business tremendous amounts of money. Realize, however, that the better you manage your time the more money you can earn. With time management, business owners maximize how much they get done each working day. Having a written time management plan serves as a guide for working smarter instead of harder.

#### TIME MANAGEMENT PLAN

The first step to better time management is a time management plan. A good time management plan must be in writing, containing a list of prioritized tasks, on a daily, weekly, and monthly basis, for achieving your goals. Then, use the time management plan to help you prioritize your work. A time management plan will keep you focused and on target to complete the most important needs in the day.

Proper goal setting starts with knowing what you want to accomplish. Try to write your goals using the following "SMART" format:

- ✓ **Specific**—state the goal precisely.
- ✓ **Measurable**—good measures allow you know when a goal is completed.
- ✓ **Attainable**—resources needed to complete the goal are within your reach.
- ✓ **Relevant**—the goal is applicable to your business.
- ✓ **Time Bound**—the goal has a completion date or timeframe for being achieved.

#### Key Element 1: Clearly Defined Written Goals

- Start your time management plan with clearly defined goals. What do you want to do? What do you want to be? What do you want to have? Your time management plan will be derived from these stated goals. When writing your goals, identify each of them as a short-term (quarterly), mid-term (12 months), or long-term (two to five years) goal.

#### Key Element 2: Detailed List of Tasks

- Breakdown each goal into a set of clearly defined tasks that need to be completed to accomplish the goal. Goals do not get accomplished on their

own. Breaking down goals into written tasks allows you to see and understand what actions are required. The task list will also help you to see what resources are needed and how to allocate them. You may see areas where resources are lacking. Use the task list to start identifying ways to get the tasks done in a timely manner.

### Key Element 3: Prioritization of the Tasks

- With any task or “to-do” list, some items on the list will be more important than others. Always try to complete the most important tasks first because these tasks will usually have the greatest impact on your goals and, by extension, your bottom line. However, some less important tasks may become critically urgent. For example, if you have an ongoing task to pay all your bills on the 15th of each month and you forget to pay the electric bill, the unpaid bill will become a high priority to avoid an interruption in service.

### Key Element 4: List of Important Ongoing Business Functions

- Many times, important ongoing business functions are not directly related to a goal and are not listed as steps or tasks. However, these functions absolutely must be completed to continue business operations. A complete list of key components of your business operations may not be attached to a goal but needs to be included in your time management plan. To start, here are examples of tasks that you might need to perform on a daily, weekly, or monthly basis.

### Key Element 5: Built in Flexibility

- Each day has only 24 hours. Your time is limited. By assigning a time estimate to complete each prioritized task, you can plan your day such that the most important tasks are always completed in a timely manner. When scheduling, avoid filling every hour of the day with tasks. Leave plenty of unscheduled time for flexibility.

## PRIORITIZING TASKS

Small business owners are usually juggling many priorities and responsibilities. The key element to making your time management plan work most efficiently is to prioritize your tasks. Your tasks will range in importance from being extremely critical to success, to something that would be

nice to have done, to an action that would not matter much even if the action never got done.

### Pareto Analysis

The Pareto principle, upon which Pareto analysis is based, is often referred to as the “80/20 rule,” which states that 20 percent of a person’s effort will produce 80 percent of the result. For example, if your goal is \$100,000 in sales, 20 percent of your effort toward this goal will result in \$80,000 in sales. The remaining 80 percent of what you do will only result in the remaining \$20,000. Use Pareto analysis to prioritize your time on tasks that produce the best overall result. Small business owners need to understand the Pareto principle because they are usually juggling many priorities.

### ABC Method

Another common method for prioritizing tasks is the ABC method, which ranks each task with the letter A, B, or C. The most important tasks on your time management plan are given the letter A, less important tasks the letter B, and the least important tasks the letter C. Once each task is assigned a letter, the subtasks for each task (A, B, and C) are further prioritized by number (1, 2, and 3). A task identified as A-1 is completed before task A-2, which is completed before task B-1, and so on through all the tasks. The ABC method can be combined with Pareto analysis.

### Eisenhower Method

The Eisenhower method is named after President Dwight D. Eisenhower, who said, “What is important is seldom urgent and what is urgent is seldom important.”

To use the Eisenhower method, take the tasks created from your goals, along with your ongoing business operational needs, and sort them into four categories:

1. **Urgent and important**—do these tasks immediately.
2. **Important but not urgent**—put these tasks on your calendar for at a later time.
3. **Urgent but not important**—delegate these tasks to someone or assign the tasks to the lowest priority.
4. **Not important and not urgent**—these tasks may never get done because tasks in the other three categories will take priority.

## Prioritize by Organizing, Streamlining, Economizing, and Contributing (POSEC) Method

The POSEC method assumes that to accomplish a goal, attention must be focused on daily responsibilities. Starting with “prioritize,” you move through each component of the POSEC method. The details of the POSEC method of time management are:

- **Prioritize**—arrange your tasks in order of importance based on your goals and available amount of time.
- **Organize**—provide a structure for your most basic tasks, especially those that are performed on a daily basis.
- **Streamline**—simplify “nuisance” tasks, such as those tasks that are required for operations but are your least preferred tasks.
- **Economize**—achieve those things you would like to do but fall low on your list of priorities.
- **Contribute**—occurs when tasks are completed and you are able to “give back” to society or to those who are in need of your help.

### ALLOCATING TIME

After prioritizing your tasks for each day of your work week, estimate the amount of time needed to complete each task on each day. You know how many hours you have to work on your business each day. If you work a full-time job and are a part-time business owner, you may only have four hours; a full-time consulting business owner may have eight hours; while a full-time retail store owner may have twelve hours. The amount of available time may also vary due to family commitments such as children or aging parents.

As you estimate the amount of time needed to work on tasks each day, do not fill up every minute of every day. Allocate about 75 percent of your work day to tasks listed in your weekly time management plan. The remaining 25 percent provides time for breaks and for any unexpected issues. On days that go according plan, use the extra 25 percent of your time for things such as additional networking, business development, handling lower priority tasks, organizing your work area, or research.

### WORK YOUR PLAN

Goals do not get achieved by wishful thinking nor does your business succeed with just hopes and dreams. Your time management plan must work. To make your plan work, you must work your plan. Do not put your time management plan on a shelf to gather dust. Action is what moves items from being thoughts, ideas, and goals into reality.

To help make your plan work, use a timer or cell phone alarm to alert you when the allotted time for a task has ended. Remember to complete deadline and highest priority tasks first to get the most impactful, and sometimes most stressful, items off your plate early. Do not work on any other tasks until your greatest priorities for the day are finished. Include 15 to 30 minutes in your schedule each day to manage your business. Also include 10 to 15 minutes at the end of each day to review the tasks for the next day in your time management plan. On the last business day of your work week, allocate at least an hour to write and prioritize your five-day weekly plan for the following week.

### REVIEW & UPDATE YOUR PLAN

#### Daily

As each task is completed, cross it off your list. Understand that critical tasks may not get done in your spare time, so allocate time to complete these tasks first.

#### Weekly

On the last day of your work week, allocate at least an hour to write and prioritize your five-day weekly time management plan for the following week.

Before writing your next weeks’ time management plan, look at any outstanding tasks from the current week, including tasks that “popped up” as the week progressed. As you reflect back over your week, ask yourself:

- ✓ Have I properly invoiced everyone based upon their activities?
- ✓ How did I do with time management and productivity this week?
- ✓ What could I do differently? Do I need to allocate my time differently?
- ✓ How well did I manage distractions?

Prioritize any outstanding tasks from the current week and add them to the time management plan

for next week, based on where the tasks fit into the list of prioritized tasks for next week.

When preparing your time management plan for next week, you should assess how accurate your estimates of time were for the preceding week. Also assess if the number of tasks included in daily and weekly plans should be reduced, increased, or left as is. Too much stress may mean you may have too many tasks in your plan. Evaluate whether your highest priority tasks are appropriately ranked.

### Monthly

Your weekly time management plans combine to determine your progress for the month. At the end of the third week of the month, assess your progress toward your monthly and quarterly goals. Ask yourself:

- ✓ How am I doing toward my monthly and quarterly goals?
- ✓ What adjustments, if any, do I need to make in my time management plan for the last week of this month to achieve my monthly and quarterly goals?

### Yearly

Your five-day weekly time management plan lists everything that needs to be done every day of the week to achieve your goals, complete projects efficiently and on time, and effectively handle all activities necessary to run your day-to-day business. This prioritized list becomes your road map or guide for each week. The weeks combine to guide you through a month, and the months combine to guide you through the year.

#### FOUR KEY POINTS TO REMEMBER

1. An effective time management plan has 5 important elements:
  1. Clearly defined written goals
  2. Detailed list of tasks
  3. Prioritization of the tasks
  4. List of the important ongoing business functions

#### 5. Built in flexibility

2. Use written SMART goals with steps and tasks to create clarity of focus. The format should be:

- **Specific**—The goal states exactly what is to be done
- **Measurable**—The point at which you know you completed the goal
- **Attainable**—You already have, or have the ability to get, the resources needed to complete the goal
- **Relevant**—What you have stated you will accomplish is within the true realm of possibility
- **Time Bound**—The completion date or timeframe for achieving your goal

3. The four ways to prioritize tasks for writing your time management plan are:

1. Pareto analysis
2. ABC method
3. Eisenhower method
4. POSEC method

4. Update time management plans daily and weekly.

## REFERENCES

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# Quiz Questions

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1. **What is the simplest and most common structure chosen to start a business?**

- Limited Liability Company
- Sole Proprietorship
- Partnership
- S Corporation

2. **Sole Proprietor business uses what tax forms?**

- Schedule C
- Form 1040
- None of the above
- Both A and B

3. **What are some of the Advantages of a Sole Proprietorship?**

- Easy and inexpensive to form
- Complete Control
- Easy tax preparation
- All of the above

4. **What tool would you use to find a listing of federal, state and local permits, licenses and registrations to help run a business?**

- Obtain business accounting software
- IRS.gov
- Secretary of State office
- Licensing and Permits tool

5. **What is considered a Partnership business?**

- A single business where one person has ownership
- A single business where two or more people share ownership

- A corporation created through an IRS tax election
- Independent legal entity owned by shareholders

6. **A partnership must file \_\_\_\_\_ to report the income, deductions, gains and losses from the business's operations.**

- Schedule C
- Annual information return
- Form 1065
- Form W-2

7. **Who is held legally liable for the actions and debts the business incurs in a corporation?**

- The corporation
- The customers
- The banks
- The share holders

8. **Corporations are required to pay \_\_\_\_\_?**

- Federal tax
- State tax
- Local tax
- All of the above

9. **True or False. Unlike sole proprietors and partnerships, corporations pay income tax on their profits.**

- True
- False

10. **What is one of the disadvantages of a corporation?**

- Corporate tax treatment
- Limited liability
- Double taxing
- None of the above

11. What corporation would you open to avoid double taxation?

- Limited Liability Corporation
- C Corporation
- Partnership
- S Corporation

12. What is the “articles of organization”?

- Defines clear lines between the shareholders and the business that improve the protection of the shareholders
- An operating agreement that structures your LLC’s finances
- Is a simple document that legitimizes your LLC and includes your business name, address and member’s names
- None of the above

13. What makes the S Corp different from a C Corp?

- Profits and losses can pass through to your personal tax return
- IRS considers it to be a unique entity, separate and apart from those who own it
- Only the shareholders are taxed not the business
- All of the above

14. True or False. Members of an LLC are considered self-employed and do not have to pay the self-employment tax contributions towards Medicare and Social Security.

- True
- False

15. What are the benefits of financial management?

- Let’s you know if you are making a profit
- Helps you decide what you can afford in all aspects of the business
- Gives you the tools to plan for overall business growth
- All of the above

16. \_\_\_\_\_ is a list of all your monthly or yearly expenses?

- Cash Flow
- Budgeting
- Time Management plan
- Book keeping

17. There are \_\_\_\_\_ basic bookkeeping steps.

- 15
- 11
- 10
- 3

18. True or False. A good time management plan must be in writing, containing a list of prioritized tasks, on a daily, weekly, and monthly basis, for achieving your goals.

- True
- False

19. What are the four methods used in prioritizing tasks?

- ABC method, Eisenhower method, Pareto Analysis, POSEC method
- Washington method, Eisenhower method, ABC method, Prozac method
- Flexibility method, Eisenhower method, Paleo method, ABC method
- POSEC method, ABC method, Streamline method, Allocating time method

20. If your business purchases an additional piece of equipment, this would be considered an investment and accounted for as an outflow of cash. If your business then sold equipment that was no longer needed, this would be considered an inflow of cash. What example does this cash flow analysis represent?

- Operating activities
- Financing activities
- Investment activities
- None of the above